

No. 12060

United States
Court of Appeals
for the Ninth Circuit

ANNA HARRIS and MORRIS HARRIS,
Petitioners,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Petition to Review a Decision of The Tax Court
of the United States

NOV 3 1948

PAUL P. O'BRIEN,

No. 12060

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THE

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Professor Sir John Peck, President of the Royal Society of Medicine

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

D. WEBSTER EGAN

DANA LATHAM

For Respondent:

T. M. MATHER

Docket No. 12984

ANNA HARRIS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 12985

MORRIS HARRIS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1947

Jan. 31—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 31—Copy of petition served on General Counsel.

Mar. 25—Answer filed by General Counsel.

1947

Mar. 25—Request for hearing in Los Angeles, California filed by General Counsel.

Mar. 27—Notice issued placing proceeding on Los Angeles, Calif. calendar. Service of answer and request made.

Dec. 8—Hearing set Jan. 26, 1948, Los Angeles.

1948

Jan. 29—Hearing had before Judge Harron on merits. Motion of counsel to consolidate granted. Petitioner allowed ten days to amend petition (see record). Appearance of Dana Latham, Esq. filed. Briefs due 3/16/48; replies due 4/16/48.

Feb. 10—Motion for leave to file the attached amended petition, amended petition lodged, filed by taxpayer.

Feb. 11—Motion for leave to file the attached amended petition granted, amended petition filed.

Feb. 12—Copy of motion and amended petition served on General Counsel.

Feb. 20—Transcript of hearing 1/29/48 filed.

Mar. 2—Answer to amended petition filed by General Counsel. 3/4/48 Copy served.

Mar. 15—Brief filed by taxpayer. 3/17/48 Copy served.

Mar. 16—Brief filed by General Counsel.

Apr. 12—Motion for extension to May 16, 1948 to file reply briefs filed by taxpayer.

1948

Apr. 13—Order, both parties time to file reply briefs extended to April 30th, entered.

Apr. 29—Reply brief filed by taxpayer. Copy served. [1 *]

May 12—Findings of fact and opinion rendered, Judge Harron. Decision will be entered for the respondent. 5/12/48 Copy served.

May 12—Decision entered, Judge Harron, Div. 13.

Aug. 4—Petition for review by U.S. Circuit Court of Appeals for the Ninth Circuit filed by taxpayer.

Aug. 4—Proof of service filed by taxpayer.

Aug. 6—Designation of contents of record on appeal and statement of points filed by taxpayer.

Aug. 6—Notice of filing designation of record and statement of points with affidavit of service by mail attached thereto filed by taxpayer.

Aug. 12—Designation of additional portions of record filed by General Counsel.

Aug. 24—Proof of service and agreement of designation of additional portions of record filed. [2]

* Page numbering appearing at foot of page of original certified Transcript of Record.

Tax Court of the United States

Docket No. 12984

ANNA HARRIS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue, set forth in his deficiency letter (LA-IT-90-d-LHP), dated December 5th, 1946, and as the basis of her appeal sets forth the following:

I.

That petitioner is a resident of the City of Los Angeles, County of Los Angeles, State of California.

II.

That the deficiency letter (a copy of which is attached), was mailed petitioner on December 5th, 1946, and states a deficiency of \$23,799.40.

III.

That the taxes in controversy are Federal Income and Victory taxes for the years 1943 and 1944.

IV.

That the determination of the taxes contained in said deficiency letter is based upon the following errors:

(a) That respondent proposes to add to tax-

payer's net income for the year 1943, the sum of \$23,807.04, said amount being the income of Albert Harris, son of taxpayer and received by the said named Albert Harris, from his undivided one-sixteenth interest of his distributive [5] share of the net income of the Union Mfg. Company, a partnership.

(b) Respondent maintains that the said named Albert Harris, is not a partner as such of the Union Mfg. Company.

(c) Respondent maintains that the net income derived from said named partnership is the community income of taxpayer and Morris Harris, her husband.

(d) Respondent proposes to disallow the sum of \$25,256.18, California income tax as a deduction in computing Victory Tax net income for the year 1943.

(e) Respondent proposes to add to taxpayer's net income for the year 1944, the sum of \$14,590.86, said amount being the income of Albert Harris, son of taxpayer, and received by the said named Albert Harris, from his undivided one-sixteenth interest of his distributive share of the net income of the Union Mfg. Company, a partnership.

(f) Respondent maintains that the said named Albert Harris, is not a partner as such of the Union Mfg. Company.

(g) Respondent maintains that the income derived from said named partnership is the community income of taxpayer and Morris Harris, her husband.

V.

The facts upon which petitioner relies as the basis of her appeal are as follows:

That on January 2nd, 1943, and for many years prior thereto taxpayer and Morris Harris, her husband were associated as co-partners doing business under the firm name of the Union Mfg. Company.

That on or about January 2nd, 1943, taxpayer as the owner of an undivided one-half interest in and to the property and assets of the Union Mfg. Company, a partnership, conveyed, transferred and delivered [6] to Albert Harris, her son, by way of gift, an undivided one-sixteenth interest in and to the property and assets of the Union Mfg. Company. That taxpayer paid to the Collector of Internal Revenue at Los Angeles, California, the gift tax due covering said mentioned gift.

That for the calendar year 1943, the said named Albert Harris, received as his distributive share of the net income of the Union Mfg. Company, the sum of \$23,807.04, and the said named Albert Harris, paid to the Collector of Internal Revenue at Los Angeles, California, Federal Income and Victory Taxes due thereon.

That for the calendar year 1943, taxpayer charged as a deduction the sum of \$25,256.18, income tax paid to the State of California, for the purpose of arriving at Victory Tax Net Income.

That for the calendar year 1944, the said named Albert Harris, received as his distributive share of

the net income of the Union Mfg. Company, the sum of \$14,590.86, and the said named Albert Harris, paid the Collector of Internal Revenue at Los Angeles, California, the Federal Income Tax due thereon.

Wherefore, petitioner prays that respondent take nothing by reason of his determination in respect to the income of Albert Harris, and Victory Tax calculation.

ANNA HARRIS,

Petitioner.

D. WEBSTER EGAN,

Attorney for Petitioner.

State of California,
County of Los Angeles—ss.

Anna Harris, being first duly sworn, on oath [7] deposes and says; that she is the petitioner in the above-entitled appeal; that she has read the foregoing petition and knows the contents thereof; that the same is true of her own knowledge, except as to the matters which are therein stated on information and belief and as those matters that she believes it to be true.

ANNA HARRIS,

Petitioner.

Subscribed and sworn to before me this 8th day of January, 1947.

FRANK LOBER,

Notary Public in and for the County of Los Angeles, State of California.

[8]

Treasury Department
Internal Revenue Service
417 South Hill Street
Los Angeles 13, California

Office of Internal Revenue Agent in Charge Los
Angeles Division

LA:IT:90D:LHB

December 5, 1946

Mrs. Anna Harris
10398 Sunset Boulevard
Los Angeles 24, California

Dear Mrs. Harris:

You are advised that the determination of your income and victory tax liability for the taxable years ended December 31, 1943 and 1944, discloses deficiency of \$23,799.40, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and for-

ward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of L.A. Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner,

By /s/ GEORGE D. MARTIN,
Internal Revenue Agent in Charge.

LHP:vac

Enclosures: Statement Form of Waiver. [9]

STATEMENT

LA:IT:90D:LHP

Mrs. Anna Harris,
10398 Sunset Boulevard,
Los Angeles 24, California.

Tax Liability for the Taxable Years Ended
December 31, 1943 and 1944

Year	Deficiency
1943 Income and victory tax.....	\$ 5,682.73
1944 Income tax	18,136.67
Total.....	<hr/> \$23,799.40

In making this determination of your income and victory tax liability careful consideration has been given to the report of examination dated August 20, 1945, to your protest dated November 5, 1945, and to the statements made at the conferences held.

A copy of this letter and statement has been mailed to your representative, Mr. D. Webster Egan, 403 West Eighth Street, Los Angeles 14, California, in accordance with the authorization contained in the power of attorney executed by you.

The family partnership of Union Manufacturing Company is held to be ineffective for income tax purposes and the income reported in the returns of the said partnership for the years 1943 and 1944 as adjusted herein is held to be the community property of you and your husband.

The dependency credit claimed in your husband's returns for the years 1942, 1943 and 1944 for your brother, Henry S. Cohn, is transferred to your return inasmuch as it has been determined that you furnished his chief support during the years under review. [10]

Adjustment to Net Income

Taxable Year Ended December 31, 1942

Net income as disclosed by return.....	\$215,785.09
Unallowable deduction:	
(a) Loss from rentals decreased.....	477.98
	<hr/>
Net income adjusted.....	\$216,263.07

Explanation of Adjustment

(a) In the rental schedule of your return you claimed a deduction of \$628.56 for depreciation, repairs, and taxes and other expenses incurred in connection with the home which you furnish rent-free to your brother, Henry C. Cohn. Of this amount, \$150.58 expended for taxes represents an allowable deduction under section 23(c) of the Internal Revenue Code. The balance, or \$477.98, is disallowed as not representing a proper deduction under section 23(a) of the Internal Revenue Code.

Computation of Tax

Taxable Year Ended December 31, 1942

Net Income Adjusted		\$216,263.07
Less: Personal exemption (claimed by husband)	\$ 0.00	
Credits for dependents.....	350.00	350.00
	<hr/>	<hr/>
Balance (surtax net income).....		\$215,913.07
Less: Earned income credit (10% of \$3,000.00).....		300.00
		<hr/>
Net income subject to normal tax.....		\$215,613.07
Normal tax at 6% on \$215,613.07.....	\$ 15,936.78	
Surtax on \$215,913.07.....	152,188.72	
	<hr/>	
Correct income tax		\$165,125.50

Adjustments to Net Income

Taxable Year Ended December 31, 1943

	Income Tax Net Income	Victory Tax Net Income
Net income as disclosed by return.....	\$137,322.14	\$143,247.29
Unallowable deductions and ad- ditional income:		
(a) Net gain from sale of capital assets	88.14	0.00
(b) Loss from rentals decreased.....	542.06	690.02
(c) Partnership income decreased....	23,630.76	23,630.76
(d) "Other deductions" disallowed	0.00	25,256.18
Total.....	\$161,583.10	\$192,824.25
Additional deduction:		
(e) Contributions increased	798.60	0.00
Net income adjusted	\$160,784.50	\$192,824.25

Explanation of Adjustments

(a) There is added to income the amount of \$88.14 representing your community share of a net gain from the sale of capital assets realized by the partnership Union Manufacturing Company, computed as follows:

	Total Income	Taxable Income	Your community share—50%
Ordinary net income, as adjusted in (c)....	\$380,560.02	\$380,560.02	\$190,280.01
Long-term capital gain (50% taxable)...	352.56	176.28	88.14
Totals.....	\$380,912.58	\$380,736.30	\$190,368.15

As previously explained, it is held that the income of this partnership is taxable to you and your husband as community income.

(b) For the reason previously explained, the deduction of \$690.02 claimed for repairs, taxes, depreciation and other [12] expenses incurred in connection with the home occupied by your brother, is disallowed to the extent of \$542.06 for income tax net income purposes. The entire amount, or \$690.02, is disallowed for the purpose of the victory tax net income. Taxes paid in the amount of \$147.96, included therein, while allowable for income tax net income under section 23(c) of the Internal Revenue Code, do not represent an allowable deduction from victory tax net income under section 451(a) of the Code.

(c) Your share of the ordinary net income of the partnership, Union Manufacturing Company, held to represent community income as previously stated, is increased by the amount of \$23,630.76, computed as follows:

Ordinary net income as shown in partnership return	\$380,912.58
Less: Amount determined to be net gain from the sale of capital assets.....	352.56
<hr/>	
Ordinary net income adjusted.....	\$380,560.02
Your community share	\$190,280.01
Amount reported in your return.....	166,649.25
<hr/>	
Increase.....	\$ 23,630.76

(d) The deduction of \$25,256.18 claimed for California income tax is disallowed as not representing a proper deduction in computing victory tax net in-

come under section 451(a) of the Internal Revenue Code.

(e) You are allowed an additional deduction of \$798.60 for contributions, representing your community share of contributions made by the partnership, Union Manufacturing Company, which were claimed, and disallowed, on the returns of your son and daughter. Since the income of such partnership is held to be the community income of you and your husband, as previously explained, the amount of contributions made by the partnership represents a community deduction, allowable to you and your husband. [13]

Computation of Alternative Tax

Taxable Year Ended December 31, 1946

Net income adjusted		\$160,784.50
Less: Excess of net long-term capital gain over net short-term capital loss		88.14
		<hr/>
Ordinary net income		\$160,696.36
Less: Personal exemption (claimed by husband)	\$ 0.00	
Credit for dependents.....	350.00	350.00
		<hr/>
Balance (surtax net income).....		\$160,346.36
Less: Earned income credit.....		300.00
		<hr/>
Balance subject to normal tax.....		\$160,046.36
Normal tax at 6% on \$160,046.36.....	\$ 9,602.78	
Surtax on \$160,346.36.....	107,020.55	
		<hr/>
Partial tax		\$116,623.33
Plus: 50% of \$88.14.....		44.07
		<hr/>
Alternative tax		\$116,667.40

Computation of Income and Victory Tax— Current Tax Payment Act of 1943

Taxable Year Ended December 31, 1943

Income tax net income adjusted.....		\$160,784.50
Less: Personal exemption (claimed by husband)	\$ 0.00	
Credit for dependents.....	350.00	350.00
		<hr/>
Surtax net income		\$160,434.50
Less: Earned income credit.....		300.00
		<hr/>
Income subject to normal tax.....		\$160,134.50
Normal tax at 6% on \$160,134.50.....	\$ 9,608.07	
Surtax on \$160,434.50.....	107,091.95	
		<hr/>
Total income tax.....		\$116,700.02
Alternative tax		\$116,667.40
Net income tax.....		\$116,667.40
Victory tax net income adjusted.....	\$192,824.25	
Less: Specific exemption.....	624.00	
		<hr/>
Income subject to victory tax.....	\$192,200.25	
Victory tax before credit (5% of \$192,200.25)	\$ 9,610.01	
Less: Victory tax credit (42%) limited to	600.00	
		<hr/>
Net victory tax.....		9,010.01
		<hr/>
1. Net income tax and victory tax.....		\$125,677.41
2. Income tax for 1942.....		165,125.50
3. Amount of item 1 or 2, whichever is larger.....		165,125.50
4. Forgiveness feature:		
(a) Amount of item 1 or 2, which- ever is smaller	\$125,677.41	
(b) Amount forgiven ($\frac{3}{4}$ of (a))	94,258.06	
		<hr/>
(c) Amount unforgiven		31,419.35
		<hr/>
5. Correct income and victory tax liability (item 3 plus item 4(c)).....		\$196,544.85
6. Income and victory tax liability shown on re- turn, account No. 909865.....		190,882.12
		<hr/>
7. Deficiency of income and victory tax		\$ 5,662.73

Adjustments to Net Income

Taxable Year Ended December 31, 1944

Net income as disclosed by return.....	\$ 92,116.88
Unallowable deduction and additional income:	
(a) Loss from rentals decreased.....	\$ 353.76
(b) Partnership income increased....	20,495.66 20,849.42
	<hr/>
Total.....	\$112,966.30
Additional deduction:	
(c) Contributions increased	469.71
	<hr/>
Net income adjusted	\$112,496.59

Explanation of Adjustments

(a) For the reason previously explained, the deduction of \$503.55 claimed for repairs, taxes, depreciation and other expenses incurred in connection with the home occupied by your brother, is disallowed to the extent of \$353.76.

(d) Your community share of the net income of the partnership, Union Manufacturing Co., is increased by the amount of \$20,495.66, computed as follows:

Ordinary net income, as shown in partner-	
ship return	\$233,453.77
Add: Repairs disallowed as represent-	
ing capital expenditures	\$ 12,048.25
Less: Depreciation allowable.....	238.66
	<hr/>
Net disallowance	11,809.59
	<hr/>
Ordinary net income adjusted.....	\$245,263.36
Your community share.....	\$122,631.68
Amount reported in your return.....	102,136.02
	<hr/>
Increase	\$ 20,495.66

The increase, or \$20,495.66, is added to income for the reason previously given.

(c) You are allowed an additional deduction of \$469.71 for contributions, representing your community share of contributions made by the partnership, Union Manufacturing Company, which were claimed on the returns of your son and daughter and, which have been disallowed to them for the reason previously given. [16]

Computation of Income Tax

Taxable Year Ended December 31, 1944

Net income, adjusted	\$112,496.59	
Less: Surtax exemptions	1,000.00	
		<hr/>
Surtax net income.....	\$111,496.59	
Surtax		\$ 77,551.97
Net income adjusted	\$112,496.59	
Less: Normal-tax exemption	500.00	
		<hr/>
Balance subject to normal tax.....	\$111,996.59	
Normal tax at 3%.....		3,359.90
		<hr/>
Correct income tax liability.....		\$ 80,911.87
Income tax liability shown on return.....		62,775.20
		<hr/>
Deficiency of income tax.....		\$ 18,136.67

[Endorsed]: T.C.U.S. Filed Jan. 31, 1947. [17]

[Title of Tax Court and Cause No. 12984.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I, II and III.

Admits the allegations contained in paragraphs I, II and III of the petition.

IV.

(a) to (g), inclusive. Denies that respondent erred as alleged in subparagraphs (a) to (g), inclusive, of paragraph IV of the petition.

V.

Admits the allegations contained in the first unnumbered subparagraph of paragraph V of the petition. [18]

Denies the allegations contained in the second and third unnumbered subparagraphs of paragraph V of the petition.

Admits the allegations contained in the fourth unnumbered subparagraph of paragraph V of the petition.

Denies the allegations contained in the fifth unnumbered subparagraph of paragraph V of the petition.

VI.

Denies each and every allegation contained in

the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

E. C. CROUTER,
A. J. HURLEY,
Special Attorneys,
Bureau of Internal Revenue.

AJH/ftc 3/17/47

[Endorsed]: T.C.U.S. Filed Mar. 25, 1947. [19]

[Title of Tax Court and Cause No. 12984.]

AMENDED PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:LHP) dated December 5, 1946, and as a basis of this proceeding alleges as follows:

I.

Petitioner is an individual residing at 10398 Sunset Boulevard, Los Angeles 24, California.

II.

The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A", was mailed to petitioner on December 5, 1946.

III.

The taxes in controversy are income and victory [20] taxes for the calendar year 1943 and income tax for the calendar year 1944 as follows:

1943	\$ 5,662.73
1944	18,136.67
<hr/>	
Total	\$23,799.40

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

1. The respondent erred in increasing petitioner's net taxable income for the calendar year 1943 in the amount of \$23,630.76, or any amount, alleged to represent the increase in petitioner's distributive share of the income of the partnership Union Manufacturing Company, of which petitioner was a partner during the calendar year 1943.

2. Respondent erred in disallowing as a deduction in computing petitioner's net income subject to Victory Tax for the calendar year 1943 \$25,256.18, representing California personal income taxes paid by petitioner to the State of California during said year 1943.

3. Respondent erred in determining that a true partnership for all purposes, including the deter-

mination of federal income tax liability did not exist during the calendar year 1943 between petitioner, Morris Harris, Albert P. Harris and Betty Harris. [21]

4. Respondent erred in determining that there was any deficiency in income and/or victory tax for the calendar year 1943.

5. The respondent erred in increasing petitioner's net taxable income for the calendar year 1944 in the amount of \$14,590.86, or any amount in excess of \$5,904.80, alleged to represent the increase in petitioner's distributive share of the income of the partnership Union Manufacturing Company, of which petitioner was a partner during the calendar year 1944.

6. Respondent erred in determining that a true partnership for all purposes, including the determination of federal income tax liability did not exist during the calendar year 1944 between petitioner, Morris Harris, Albert P. Harris and Betty Harris.

7. Respondent erred in determining that there was any deficiency in income tax for the calendar year 1944.

V.

The facts upon which petitioner relies as a basis of this proceeding are as follows:

1. For many years prior to January 2, 1943, petitioner and her husband, Morris Harris, were and had been associated together as equal co-partners under the firm name of Union Manufacturing

Company. The validity of [22] said partnership for federal income tax and all other purposes has never been questioned by respondent or any other person.

2. On or about January 2, 1943, petitioner conveyed to Albert P. Harris, son of petitioner and her husband Morris Harris, by way of gift, an undivided 1/16th interest in and to the properties and assets of said partnership, Union Manufacturing Company. Pursuant to said gift, petitioner filed with the Collector of Internal Revenue at Los Angeles, California, appropriate federal gift tax returns and paid the federal gift taxes determined to be due on account of said gift.

3. On or about the same date, January 2, 1943, petitioner's husband, Morris Harris, conveyed to Betty Harris, the daughter of petitioner and her said husband, a 1/16th interest in the properties and assets of said Union Manufacturing Company. Said Morris Harris filed with the Collector of Internal Revenue at Los Angeles, California, appropriate federal gift tax returns covering said gift, and paid the gift tax determined to be due on account of said gift.

4. On or about said date, January 2, 1943, said parties, petitioner herein, her husband Morris Harris, said Albert P. Harris, and Betty Harris, agreed to associate themselves as co-partners and to carry on said business under the name of Union Manufacturing Company. [23] Said Albert P. Harris contributed to said partnership the 1/16th un-

divided interest in the properties and assets of the former partnership, Union Manufacturing Company, acquired by him from his mother by gift as heretofore recited. Said Betty Harris contributed to said partnership the 1/16th undivided interest in the properties and assets of the former partnership, Union Manufacturing Company, acquired by her from her father by gift as heretofore recited. Petitioner herein and her husband, Morris Harris, each contributed their 7/16ths interest in the properties and assets of said Union Manufacturing Company remaining to them after the gifts as aforesaid.

Said co-partners agreed to share profits and losses on the following basis:

Anna Harris	7/16ths
Morris Harris	7/16ths
Albert P. Harris	1/16th
Betty Harris	1/16th

In connection with said partnership there were no restrictions of any kind or nature upon the activities, rights of withdrawal, etc., of any of the partners.

5. Throughout the calendar years 1943 and 1944 said partnership, composed of the four persons above referred to, conducted its business and affairs on a partnership basis and filed appropriate federal income tax returns on said basis. Despite this fact respondent [24] erroneously and without warrant in fact or law has ignored said partner-

ship and has charged all the income of said partnership for said calendar years 1943 and 1944 one-half to petitioner herein and one-half to her husband, Morris Harris.

6. During the calendar year 1943 petitioner herein paid to the State of California, as personal income taxes upon her income for the calendar year 1942 the sum of \$25,256.18. In determining her victory tax liability for said calendar year 1943 petitioner deducted the amount of said payment. Respondent erroneously and without warrant in fact or law was refused to allow said deduction in determining petitioner's net income for the calendar year 1943 subject to victory tax.

Wherefore, petitioner prays that this Court may hear this proceeding and determine:

1. That the respondent erred in the particulars set forth in paragraph IV of this petition.

2. That there is no deficiency in income or victory taxes for the calendar year 1943 and no deficiency in income tax for the calendar year 1944.

February 6, 1948.

Respectfully submitted,

/s/ D. WEBSTER EGAN,

/s/ DANA LATHAM,

Counsel for Petitioner.

[Verified.] [25]

[Clerk's Note: Exhibit "A", Notice of Deficiency, is attached to original Petition and is not reproduced here.]

[Title of Tax Court and Cause No. 12984.]

ANSWER TO AMENDED PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the amended petition filed by the above-named petitioner admits and denies as follows:

I, II and III. Admits the allegations contained in paragraphs I, II and III of the amended petition.

IV (1) to (7), inclusive. Denies that the Commissioner erred in the determination of the deficiencies as alleged in paragraph IV of the amended petition and subparagraphs (1) to (7), inclusive, thereunder.

V (1). Admits the allegations contained in subparagraph (1) of paragraph V of the amended petition.

V (2). Admits that petitioner filed with the Collector of Internal Revenue at Los Angeles, California, federal gift tax returns, but denies the remaining allegations contained in subparagraph (2) of paragraph V of the amended petition. [36]

V (3). Admits that Morris Harris filed with the Collector of Internal Revenue at Los Angeles, California, federal gift tax returns, but denies the remaining allegations contained in subparagraph (3) of paragraph V of the amended petition.

V (4) and (5). Denies the allegations contained

in subparagraphs (4) and (5) of paragraph V of the amended petition.

V (6). Admits that during the calendar year 1943 petitioner herein paid to the State of California, as personal income taxes upon her income for the calendar year 1942 the sum of \$25,256.18; that in determining her victory tax liability for said calendar year 1943 petitioner deducted the amount of said payment; that respondent has refused to allow said deduction in determining petitioner's net income for the calendar year 1943 subject to victory tax, but denies the remaining allegations contained in subparagraph (6) of paragraph V of the amended petition.

VI. Denies generally and specifically each and every allegation in the amended petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel;
E. C. CROUTER,
T. M. MATHER,
Special Attorneys,

TMM:b 2/25/48 Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Mar. 2, 1948. [37]

Tax Court of the United States

Docket No. 12985

MORRIS HARRIS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue, set forth in his deficiency letter (LA-IT-90-D-LHP), dated December 5th, 1946, and as the basis of his appeal sets forth the following:

I.

That petitioner is a resident of the City of Los Angeles, County of Los Angeles, State of California.

II.

That the deficiency letter (a copy of which is attached), was mailed petitioner on December 5th, 1946, and states a deficiency of \$24,728.97.

III.

That the taxes in controversy are Federal Income and Victory Taxes for the years 1943 and 1944.

IV.

That the determination of the taxes contained in said deficiency letter is based upon the following errors:

(a) That respondent proposes to add to taxpayer's net income for the year 1943, the sum of \$23,807.04, said amount being the income of Betty Harris, daughter of taxpayer and received by the said named Betty Harris, from her undivided one-sixteenth interest of her distributive [38] share of the net income of the Union Manufacturing Company, a partnership.

(b) Respondent maintains that the said named Betty Harris, is not a partner as such of the Union Manufacturing Company.

(c) Respondent maintains that the net income derived from said named partnership is the community income of taxpayer and Anna Harris, his wife.

(d) Respondent proposes to disallow the sum of \$26,747.65, California income tax as a deduction in computing Victory Tax net income for the year 1943.

(e) Respondent proposes to add to taxpayer's net income for the year 1944, the sum of \$14,590.86, said amount being the income of Betty Harris, daughter of taxpayer, and received by the said named Betty Harris, from her undivided one-sixteenth interest of her distributive share of the net income of the Union Manufacturing Company, a partnership.

(f) Respondent maintains that the said named Betty Harris, is not a partner as such of the Union Manufacturing Company.

(g) Respondent maintains that the income derived from said named partnership is the community income of taxpayer and Anna Harris, his wife.

V.

The facts upon which petitioner relies as the basis of his appeal are as follows:

That on January 2nd, 1943, and for many years prior thereto taxpayer and Anna Harris, his wife, were associated as co-partners doing business under the firm name of the Union Manufacturing Company.

That on or about January 2nd, 1943, taxpayer as the owner of an undivided one-half interest in and to the property and assets of the Union Manufacturing Company, a partnership, conveyed, transferred and delivered [39] to Betty Harris, his daughter, by way of gift, an undivided one-sixteenth interest in and to the property and assets of the Union Manufacturing Company. That taxpayer paid to the Collector of Internal Revenue at Los Angeles, California, the gift tax due covering said mentioned gift.

That for the calendar year 1943, the said named Betty Harris, received as her distributive share of the net income of the Union Manufacturing Company, the sum of \$23,807.04, and the said named Betty Harris, paid to the Collector of Internal Revenue at Los Angeles, California, Federal Income and Victory Taxes due thereon.

That for the year 1943, taxpayer charged as a deduction the sum of \$26,747.65, income tax paid to the State of California, for the purpose of arriving at Victory Tax Net Income.

That for the calendar year 1944, the said named Betty Harris, received as her distributive share of the net income of the Union Manufacturing Company, the sum of \$14,590.86, and the said named Betty Harris, paid to the Collector of Internal Revenue at Los Angeles, California, the Federal Income Tax due thereon.

Wherefore, petitioner prays that respondent take nothing by reason of his determination except the tax due covering the disallowance of certain building repairs.

MORRIS HARRIS,

Petitioner.

D. WEBSTER EGAN,

Attorney for Petitioner.

State of California,
County of Los Angeles—ss.

Morris Harris, being first duly sworn, on oath, deposes and says; that he is the petitioner in the above-entitled appeal; [40] that he has read the foregoing petition and knows the contents thereof; that the same is true of his own knowledge, except as to the matters which are therein stated on in-

formation and belief and as those matters that he believes it to be true.

MORRIS HARRIS,
Petitioner.

Subscribed and sworn to before me this 8th day
of January, 1947.

FRANK LOBER,
Notary Public in and for the County of Los An-
geles, State of California. [41]

Treasury Department
Internal Revenue Service

417 South Hill Street
Los Angeles 13, California

Office of Internal Revenue Agent in Charge Los
Angeles Division

LA:IT:90D:LHP

Dec. 5, 1946

Mr. Morris Harris
10398 Sunset Boulevard
Los Angeles 24, California

Dear Mr. Harris:

You are advised that the determination of your
income and victory tax liability for the taxable
years ended December 31, 1943 and 1944 discloses
a deficiency of \$24,728.97, as shown in the statement
attached.

In accordance with the provisions of existing in-

ternal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for th attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner,

By /s/ GEORGE D. MARTIN,
Internal Revenue Agent in Charge.

LHP:vmc

Enclosures: Statement, Form of Waiver. [42]

STATEMENT

LA:IT:90D:LHP

Mr. Morris Harris,
10398 Sunset Boulevard,
Los Angeles 24, California.

Tax Liability for the Taxable Years Ended
December 31, 1943 and 1944

Year	Deficiency
1943 Income and victory tax.....	\$ 6,035.87
1944 Income tax	18,693.10
Total.....	<u>\$24,728.97</u>

In making this determination of your income and victory tax liability careful consideration has been given to the report of examination dated August 20, 1945, to your protest dated November 5, 1945, to the statements made at the conferences held, and to your claim for refund filed on April 13, 1945, for the year 1944.

A copy of this letter and statement has been mailed to your representative, Mr. D. Webster Egan, 403 West Eighth Street, Los Angeles 14, California, in accordance with the authorization contained in the power of attorney executed by you.

The issue raised in your claim for refund for the taxable year ended December 31, 1944, relative to that portion of your distributable income reported from the partnership "Union Ranch", which represents gain from the sale or exchange of capital assets held for more than six months, is conceded and appropriate adjustments therefor is made herein.

The family partnership of Union Manufacturing Company is held to be ineffective for income tax purposes and the income reported in the returns of the said partnership for the years 1943 and 1944 as adjusted herein is held to be the community property of you and your wife. [43]

The dependency credit claimed in your returns for the years 1942, 1943 and 1944 for your brother-in-law, Henry S. Cohn, is transferred to the return of your wife inasmuch as it has been determined that she furnished his chief support during the years under review.

Adjustment to Net Income

Taxable Year Ended December 31, 1942

Net income as disclosed by return.....	\$228,931.78
Unallowable deductions:	
(a) Gasoline tax	45.75
	<hr/>
Net income adjusted	\$228,977.53

Explanation of Adjustment

(a) The deduction of \$45.75 for gasoline taxes paid to the State of California is disallowed as not representing taxes deductible under section 23(c) of the Internal Revenue Code.

Computation of Tax

Taxable Year Ended December 31, 1942

Net Income Adjusted		\$228,977.53
Less: Personal exemption.....	\$1,200.00	
Credit for dependents.....	700.00	1,900.00
	<hr/>	<hr/>
Balance (surtax net income).....		\$227,077.53
Less: Earned income credit (10% of \$14,000.00).....		1,400.00
		<hr/>
Net income subject to normal tax.....		\$225,677.53
Normal tax at 6% on \$225,677.53.....	\$ 13,540.65	
Surtax on \$227,077.53.....	161,343.57	
	<hr/>	
Correct income tax.....		\$174,884.22

Adjustments to Net Income

Taxable Year Ended December 31, 1943

	Income Tax Net Income	Victory Tax Net Income
Net income as disclosed by return.....	\$148,201.50	\$156,171.72
Additional income:		
(a) Net gain from sale of capital assets	88.14	
(b) Partnership income increased.....	23,630.76	23,630.76
(c) Taxes	0.00	26,747.65
	<hr/>	<hr/>
Total.....	\$171,920.40	\$206,550.13
Additional deduction:		
(d) Contributions increased	798.60	0.00
	<hr/>	<hr/>
Net income adjusted.....	\$171,121.80	\$206,550.13

Explanation of Adjustments

(a) There is added to income the amount of \$88.14 representing your community share of a net gain from the sale of capital assets realized by the part-

nership Union Manufacturing Company, computed as follows:

	Total Income	Taxable Income	Your community share—50%
Ordinary net income, as adjusted in (b).....	\$380,560.02	\$380,560.02	\$190,280.01
Long-term capital gain (50% taxable)	352.56	176.28	88.14
Totals.....	\$380,912.58	\$380,736.30	\$190,368.15

As previously explained, it is held that the income of this partnership is taxable to you and your wife as community income.

(b) Your share of the ordinary net income of the partnership, Union Manufacturing Company, held to represent community income as previously stated, is increased by the amount of \$23,630.76, computed as follows: [45]

Ordinary net income as shown in partnership return.....	\$380,912.58
Less: Amount determined to be net gain from the sale of capital assets.....	352.56
Ordinary net income adjusted.....	\$380,560.02
Your community share.....	\$190,280.01
Amount reported in your return.....	166,649.25
Increase	\$ 23,630.76

(c) The deduction of \$26,747.65 claimed for California income tax is disallowed as not representing a proper deduction in computing victory tax net income under section 451(a) of the Internal Revenue Code.

(d) You are allowed an additional deduction of \$798.60 for contributions, representing your community share of contributions made by the partnership, Union Manufacturing Company, which were

claimed, and disallowed, on the returns of your son and daughter. Since the income of such partnership is held to be the community income of you and your wife, as previously explained, the amount of contributions made by the partnership represents a community deduction, allowable to you and your wife.

Computation of Alternative Tax

Taxable Year Ended December 31, 1943

Net income adjusted.....	\$171,121.80	
Minus: Excess of net long-term capital gain over net-		
short-term capital loss		88.14
		<hr/>
Ordinary net income.....	\$171,033.66	
Less: Personal exemption	\$1,200.00	
Credit for dependents	700.00	1,900.00
	<hr/>	<hr/>
Balance (surtax net income).....	\$169,133.66	
Less: Earned income credit.....		1,400.00
		<hr/>
Net income subject to normal tax.....	\$167,733.66	
Normal tax at 6% on \$167,733.66.....	\$ 10,064.02	
Surtax on \$169,133.66	114,138.26	
	<hr/>	
Partial tax	\$124,202.28	
Plus: 50% of \$88.14.....		44.07
Alternative tax		124,246.35

Computation of Income and Victory Tax—Current Tax Payment Act of 1943

Taxable Year Ended December 31, 1943

Income tax net income adjusted.....	\$171,121.80
Less: Personal exemption.....	\$1,200.00
Credit for dependents.....	700.00
	1,900.00
Surtax net income	\$169,221.80
Less: Earned income credit.....	1,400.00
Income subject to normal tax.....	\$167,821.80
Normal tax at 6% on \$167,821.80.....	\$ 10,069.31
Surtax on \$169,221.80	114,209.66
Total income tax.....	\$124,278.97
Alternative tax	\$124,246.35
Net income tax.....	\$124,246.35
Victory tax net income adjusted.....	\$206,550.13
Less: Specific exemption	624.00
Income subject to victory tax.....	\$205,926.13
Victory tax before credit (5% of \$205,926.13)	\$ 10,296.31
Less: Victory Tax credit.....	700.00
Net victory tax.....	\$ 9,596.31
1. Net income tax and victory tax.....	\$133,842.66
2. Income tax for 1942.....	\$174,884.22
3. Amount of item 1 or 2, whichever is larger.....	\$174,884.22
4. Forgiveness feature:	
(a) Amount of item 1 or 2, whichever is smaller	\$133,842.66
(b) Amount forgiven ($\frac{3}{4}$ of (a))....	100,382.00
(c) Amount unforgiven	33,460.66
5. Correct income and victory tax liability (item 3 plus item 4(c)).....	\$208,344.88
6. Income and victory tax liability shown on return, account No. 909866.....	202,309.01
7. Deficiency of income and victory tax.....	\$ 6,035.87

Adjustments to Net Income

Taxable Year Ended December 31, 1944

Net income as disclosed by return.....	\$107,498.21
Additional income:	
(a) Net gain from sale of capital assets	\$ 418.48
(b) Partnership income increased....	20,077.17 20,495.65
Total.....	\$127,993.86
Additional deduction:	
(c) Contributions	469.71
Net income adjusted.....	\$127,524.15

Explanation of Adjustments

(a) In your return you reported the amount of \$1,125.98 as representing your distributive share of the ordinary net income of the partnership Union Ranch. In a claim for refund filed by you on April 13, 1945, it is stated that \$418.49 of this amount actually represents your distributive share of a net gain from the sale of capital assets realized by the partnership. The amount of \$418.48, computed as follows, is accordingly added to income, and is eliminated from partnership ordinary net income in adjustment (b): [48]

	Total Income	Taxable Income	Your distributive share—50%
Ordinary net income of partnership	\$1,415.00	\$1,415.00	\$ 707.50
Long-term capital gain (50% taxable)	1,673.93	836.97	418.48
Totals.....	\$3,088.93	\$2,251.97	\$1,125.98

(b) Your community share of the ordinary net income of the partnerships named below is increased by the amount of \$20,077.17, computed as follows:

	Reported	Corrected	Increase (Decrease)
1. Union Manufactur-			
ing Co.	\$102,136.03	\$122,631.68	\$ 20,495.65
2. Union Ranch	1,125.98	707.50	(418.48)
Totals.....	\$103,262.01	\$123,339.18	\$ 20,077.17

1. As previously stated, it has been determined that the net income of this partnership, adjusted as follows, represents community income:

Ordinary net income, as shown in partnership return..	\$233,453.77
Add: Repairs disallowed as representing capital expenditures	\$ 12,048.25
Less: Depreciation allowable.....	238.66
Net disallowance	11,809.59
Ordinary net income adjusted.....	\$245,263.36
Your community share.....	\$122,631.68
Amount reported in your return.....	\$102,136.03
Increase	\$ 20,495.65

2. See adjustment (a).

[49]

(c) You are allowed an additional deduction of \$469.71 for contributions, representing your community share of contributions made by the partnership, Union Manufacturing Company, which were claimed on the returns of your son and daughter and which have been disallowed to them for the reason previously given.

Computation of Alternative Tax Taxable Year Ended December 31, 1944

Net income adjusted.....	\$127,524.15	
Less: Excess of net long-term capital gain over net short-term capital loss		418.48
Ordinary net income.....	\$127,105.67	
Less: Surtax exemptions.....	1,500.00	
Balance (surtax net income).....	\$125,605.67	
Surtax	\$ 90,109.05	
Ordinary net income.....	\$127,105.67	
Less: Normal-tax exemption	500.00	
Balance subject to normal tax.....	\$126,605.67	
Normal tax at 3%.....		3,798.17
Partial tax	\$ 93,907.22	
Plus: 50% of \$418.48.....		209.24
Alternative tax	\$ 94,116.46	

Computation of Income Tax Taxable Year Ended December 31, 1944

Net income adjusted.....	\$127,524.15	
Less: Surtax exemptions.....	1,500.00	
Surtax net income	\$126,024.15	
Surtax		\$ 90,481.49
Net income adjusted	\$127,524.15	
Less: Normal-tax exemption	500.00	
Balance subject to normal tax.....	\$127,024.15	
Normal tax at 3%.....		3,810.72
Total income tax	\$ 94,292.21	
Total alternative tax.....	\$ 94,116.46	
Correct income tax liability.....	\$ 94,116.46	
Income tax liability shown on return.....	\$ 75,423.36	
Deficiency of income tax—.....	\$ 18,693.10	

[Endorsed]: T.C.U.S. Filed Jan. 31, 1947. [51]

[Title of Tax Court and Cause No. 12985.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I, II and III.

Admits the allegations contained in paragraphs I, II and III of the petition.

IV.

(a) to (g), inclusive. Denies that respondent erred as alleged in subparagraphs (a) to (g), inclusive, of paragraph IV of the petition.

V.

Admits the allegations contained in the first unnumbered subparagraph of paragraph V of the petition. [52]

Denies the allegations contained in the second and third unnumbered subparagraphs of paragraph V of the petition.

Admits the allegations contained in the fourth unnumbered subparagraph of paragraph V of the petition.

Denies the allegations contained in the fifth unnumbered subparagraph of paragraph V of the petition.

VI.

Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

E. C. CROUTER,
A. J. HURLEY,
Special Attorneys,
Bureau of Internal Revenue.

AJH/ftc 3/17/47

[Endorsed]: T.C.U.S. Filed Mar. 25, 1947. [53]

[Title of Tax Court and Cause No. 12985.]

AMENDED PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:LHP) dated December 5, 1946, and as a basis of this proceeding alleges as follows:

I.

Petitioner is an individual residing at 10398 Sunset Boulevard, Los Angeles 24, California.

II.

The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A", was mailed to petitioner on December 5, 1946.

III.

The taxes in controversy are income and victory [54] taxes for the calendar year 1943 and income tax for the calendar year 1944 as follows:

1943	\$ 6,035.87
1944	18,693.10
<hr/>	
Total	\$24,728.97

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

1. The respondent erred in increasing petitioner's net taxable income for the calendar year 1943 in the amount of \$23,630.76, or any amount, alleged to represent the increase in petitioner's distributive share of the income of the partnership Union Manufacturing Company, of which petitioner was a partner during the calendar year 1943.

2. Respondent erred in disallowing as a deduction in computing petitioner's net income subject to victory tax for the calendar year 1943 \$26,747.65, representing California personal income

taxes paid by petitioner to the State of California during said year 1943.

3. Respondent erred in determining that a true partnership for all purposes, including the determination of federal income tax liability did not exist during the calendar year 1943 between petitioner, Anna Harris, Albert P. Harris and Betty Harris. [55]

4. Respondent erred in determining that there was any deficiency in income and/or victory tax for the calendar year 1943.

5. The respondent erred in increasing petitioner's net taxable income for the calendar year 1944 in the amount of \$14,590.86, or any amount in excess of \$5,904.80, alleged to represent the increase in petitioner's distributive share of the income of the partnership Union Manufacturing Company, of which petitioner was a partner during the calendar year 1944.

6. Respondent erred in determining that a true partnership for all purposes, including the determination of federal income tax liability did not exist during the calendar year 1944 between petitioner, Anna Harris, Albert P. Harris and Betty Harris.

7. Respondent erred in determining that there was any deficiency in income tax for the calendar year 1944.

V.

The facts upon which petitioner relies as a basis of this proceeding are as follows:

1. For many years prior to January 2, 1943, petitioner and his wife, Anna Harris, were and had been associated together as equal co-partners under the firm name of Union Manufacturing Company. The validity of said partnership for federal income tax and all other [56] purposes has never been questioned by respondent or any other person.

2. On or about January 2, 1943, petitioner conveyed to Betty Harris, daughter of petitioner and his wife Anna Harris, by way of gift, an undivided 1/16th interest in and to the properties and assets of said partnership, Union Manufacturing Company. Pursuant to said gift, petitioner filed with the Collector of Internal Revenue at Los Angeles, California, appropriate federal gift tax returns and paid the federal gift tax determined to be due on account of said gift.

3. On or about the same date, January 2, 1943, petitioner's wife, Anna Harris, conveyed to Albert P. Harris, the son of petitioner and his said wife, a 1/16th interest in the properties and assets of said Union Manufacturing Company. Said Anna Harris filed with the Collector of Internal Revenue at Los Angeles, California, appropriate federal gift tax returns covering said gift, and paid the gift tax determined to be due on account of said gift.

4. On or about said date, January 2, 1943, said parties, petitioner herein, his wife Anna Harris, said Albert P. Harris and Betty Harris, agreed to associate themselves as co-partners and to carry on said business under the name of Union Manu-

facturing Company. Said [57] Albert P. Harris contributed to said partnership the 1/16th undivided interest in the properties and assets of the former partnership, Union Manufacturing Company, acquired by him from his mother by gift as heretofore recited. Said Betty Harris contributed to said partnership the 1/16th undivided interest in the properties and assets of the former partnership, Union Manufacturing Company, acquired by her from her father by gift as heretofore recited. Petitioner herein and his wife, Anna Harris, each contributed their 7/16ths interest in the properties and assets of said Union Manufacturing Company remaining to them after the gifts as aforesaid.

Said co-partners agreed to share profits and losses on the following basis:

Morris Harris	7/16ths
Anna Harris	7/16ths
Albert P. Harris	1/16th
Betty Harris	1/16th

In connection with said partnership there were no restrictions of any kind or nature upon the activities, rights of withdrawal, etc., of any of the partners.

5. Throughout the calendar years 1943 and 1944 said partnership, composed of the four persons above referred to, conducted its business and affairs on a partnership basis and filed appropriate federal income tax returns on said basis. Despite this fact respondent erroneously and without war-

rant in fact or law has [58] ignored said partnership and has charged all the income of said partnership for said calendar years 1943 and 1944 one-half to petitioner herein and one-half to his wife, Anna Harris.

6. During the calendar year 1943 petitioner herein paid to the State of California, as personal income taxes upon his income for the calendar year 1942 the sum of \$26,747.65. In determining his victory tax liability for said calendar year 1943 petitioner deducted the amount of said payment. Respondent erroneously and without warrant in fact or law has refused to allow said deduction in determining petitioner's net income for the calendar year 1943 subject to victory tax.

Wherefore, petitioner prays that this Court may hear this proceeding and determine:

1. That the respondent erred in the particulars set forth in paragraph IV of this petition.
2. That there is no deficiency in income or victory taxes for the calendar year 1943 and no deficiency in income tax for the calendar year 1944.

February 6, 1948.

Respectfully submitted,

/s/ D. WEBSTER EGAN,

/s/ DANA LATHAM,

Counsel for Petitioner.

(Verified.)

[59]

[Clerk's Note: Exhibit "A", Notice of Deficiency, is attached to original Petition and is not reproduced here.]

[Title of Tax Court and Cause No. 12985.]

ANSWER TO AMENDED PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the amended petition filed by the above-named petitioner admits and denies as follows:

I, II and III. Admits the allegations contained in paragraphs I, II and III of the amended petition.

IV (1) to (7), inclusive. Denies that the Commissioner erred in the determination of the deficiencies as alleged in paragraph IV of the amended petition and subparagraphs (1) to (7), inclusive, thereunder.

V (1). Admits the allegations contained in subparagraph (1) of paragraph V of the amended petition.

V (2). Admits that petitioner filed with the Collector of Internal Revenue at Los Angeles, California, federal gift tax returns, but denies the remaining allegations contained in subparagraph (2) of paragraph V of the amended petition. [70]

V (3). Admits that Anna Harris filed with the Collector of Internal Revenue at Los Angeles, California, federal gift tax returns, but denies the remaining allegations contained in subparagraph (3) of paragraph V of the amended petition.

V (4) and (5). Denies the allegations contained

in subparagraphs (4) and (5) of paragraph V of the amended petition.

V (6). Admits that during the calendar year 1943 petitioner herein paid to the State of California, as personal income taxes upon his income for the calendar year 1942 the sum of \$26,747.65; that in determining his victory tax liability for said calendar year 1943 petitioner deducted the amount of said payment; that respondent has refused to allow said deduction in determining petitioner's net income for the calendar year 1943 subject to victory tax, but denies the remaining allegations contained in subparagraph (6) of paragraph V of the amended petition.

VI. Denies generally and specifically each and every allegation in the amended petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
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TMM:b 2/25/48

[Endorsed]: T.C.U.S. Filed Mar. 2, 1948. [71]

10 T. C. No. 109

The Tax Court of the United States

Anna Harris, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Morris Harris, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket Nos. 12984, 12985. Promulgated May 12, 1948.

1. Petitioners are co-partners, carrying on a manufacturing business under the name of Union Manufacturing Company. They have two children. Each own an undivided one-half interest in the business, and entitled to receive one-half of the profits each year. As of January 1, 1943, each petitioner purportedly gave an undivided, one-sixteenth interest in the business to each child. Neither child contributed any capital originating with himself; and during 1943 neither child performed any services in the business. Under the facts, held, that petitioners did not create a new and bona fide partnership in 1943, and that their two children were not co-partners with them in the conduct of the partnership business known as Union Manufacturing Company. *Commissioner vs. Tower*, 327 U. S. 280, followed.

2. Each petitioner paid personal income taxes to the State of California for the year 1942 under the California income tax law. The California income taxes were not paid in connection with the carry-

ing on of a trade or business, or otherwise within the meaning of section 451(a)(3) of the I.R.C. Held, that under the provisions of section 451(a)(3) the amount which is paid for state income taxes is not deductible in computing victory tax net income. [72]

D. Webster Egan, Esq., and Dana Latham, Esq., for the petitioners.

T. M. Mather, Esq., for the respondent.

Respondent has determined deficiencies in income tax as follows:

	1943	1944
Anna Harris, Docket No. 12984.....	\$5,682.73	\$18,136.67
Morris Harris, Docket No. 12985.....	6,035.87	18,693.10

There are two questions presented, whether two children are members of a partnership, and whether income taxes of the State of California are deductible in computing the victory tax net income for the year 1943.

Petitioners filed separate income tax returns with the collector for the sixth district of California.

FINDINGS OF FACT

Morris Harris and Anna Harris are husband and wife. They reside in Los Angeles, California. Albert J. Harris and Betty Harris are children of petitioners. They were nineteen years old and sixteen years old, respectively, in 1943.

Petitioners are associated together as equal co-partners under the firm name of Union Manufacturing Company. They had been associated in part-

nership for many years prior to 1943. Each owns a one-half interest in the partnership and profits, under a written agreement dated April 1, 1937, which covers a term of 10 years.

Union Manufacturing Company has its main plant in Los Angeles. It carries on the business of the manufacture and sale of men's work and sport clothes.

In 1909, Morris Harris began this enterprise. The capital employed has been built up by retaining profits from year to year. Morris Harris is the manager. In [73] 1941 the volume of sales was around \$2,000,000. In 1942, about 400 people were employed in the Los Angeles plant. Union Manufacturing Company had a second place of business in 1942 in El Paso, Texas, where around 100 people were employed; and the employment in El Paso increased to about 300 later. Morris Harris owns the land and building where the Los Angeles plant is located, and it does not appear as an asset in the balance sheet of the firm. In 1942, the Los Angeles plant and real estate had a value of around \$300,000, without equipment. The equipment which is used in the plant consists of all kinds of machinery and sewing machines. In the manufacturing departments there are several floor ladies under one superintendent. The goods manufactured are sold all over the United States. In 1942, the market was limited to the Rocky Mountain and Pacific Coast regions and ten or twelve salesmen were

employed on a commission basis. In 1942, and thereafter, goods were sold in chain stores. Morris receives a salary of about \$200 a week which constitutes a drawing account against his share of the profits.

As of December 31, 1942, the Union Manufacturing Company had assets of \$945,975.23, of which inventory amounted to \$538,992. Liabilities amounted to only \$9,065.40, leaving net assets of \$936,909.83.

As of December 31, 1942, after the addition of one-half of 1942 profits, the balance of the capital account of Morris Harris was \$471,351.04; and the balance of the capital account of Anna Harris was \$465,558.79.

The balance sheet of the partnership as of December 31, 1942, was as follows: [74]

ASSETS

Petty Cash	\$	35.49	
Union Bank & Trust Co.—			
Checking Acct.		166,571.62	
Union Bank & Trust Co.—Payroll Acct.		100.00	
State National Bank—El Paso, Tex.....		7,797.08	
Accounts Receivable—Good		187,880.36	
Accounts Receivable—Doubtful.....		1,788.20	
Loans to Employees		106.73	
Inventory 12/21/42		538,992.70	
Machinery		40,211.68	
Furniture & Fixtures.....		694.09	
Automobile		859.80	
Stationery & Printing.....		400.00	
Prepaid Insurance		537.48	\$945,975.23

LIABILITIES

Employees—Salaries, commissions etc...\$	449.94	
Social Security—Employees	2,240.74	
Social Security—Firm	6,374.72	\$ 9,065.40

CAPITAL

Mr. Harris	\$359,705.94	
Less drawing acct.....\$28,050.00		
Less income tax 1941.... 86,238.30		
Less income tax 1940		
(add.)	92.08	114,380.38
		245,325.56
Plus 1/2 1942 profits.....	226,025.48	471,351.04
A. Harris:	\$334,699.14	
Less drawing acct.....\$14,949.35		
Less income tax 1941.... 80,216.48	95,165.83	
		239,533.31
Plus 1/2 1942 profits.....	226,025.48	465,558.79
		\$945,975.23

The son of petitioners, Albert, finished high school in June 1941; he entered the University of Virginia in the fall of 1941. He continued in the University of Virginia for the academic year 1941-1942, returning to Los Angeles in June of 1942. During the summer of 1942 he attended evening classes at the University of Southern California, where he took special courses in textiles. In September 1942, he entered the textiles school of the University of North Carolina at Raleigh, North Carolina. He returned home for the Christmas holidays of 1942. He enlisted in the Army in [75] December 1942. Thereafter, he returned to Raleigh,

North Carolina, where he remained at the University of North Carolina until April 1943, when he was called for active duty in the armed forces. He was in the service from April 1943 until January 1946. Upon his discharge from the service he returned to Los Angeles and went to work in the business of Union Manufacturing Company.

Betty, petitioners' daughter, attended school during the years 1943 and 1944 at either University High School, Flintridge School or Mills College in California.

In 1942, in the summer months and at Christmas, petitioners discussed the matter of making a gift of an interest in the partnership to their son, and they considered it fair to do the same for their daughter. The arrangement discussed was not carried to any formal agreement; there was no written agreement, and there were no instruments of gifts or assignments or transfers drawn up or executed. In the discussions, Anna Harris was to make gift of part of her partnership interest to her son, Albert, and Morris Harris was to make gift of part of his interest to his daughter, Betty. The gifts were to be made on or about January 2, 1943.

On September 16, 1943, book entries were made in the capital accounts of Anna and Morris Harris, and ledger sheets were made opening capital accounts in the names of Albert and Betty. However, instead of making book entries to show a transfer of an interest from Anna to her son Albert, and

from Morris to his daughter Betty, the entries which were made transferred an amount out of Anna's capital account to Betty, and an amount out of Morris' capital account to Albert. These bookkeeping entries did not correspond with or reflect statements which were made on Form 709, Gift Tax [76] Return, to the effect that Anna Harris had made gift to Albert Harris on January 2, 1943, of an undivided one-sixteenth interest in the property and assets of Union Manufacturing Company; and that Morris Harris had made gift to Betty Harris on January 2, 1943, of an undivided one-sixteenth interest in the property and assets of Union Manufacturing Company.

The two gift tax returns of each petitioner were dated September 27, 1943.

The capital account of Morris Harris, on September 16, 1943, was debited with the amount \$34,083.70, and a capital account in the name of Albert Harris, was credited with the same amount as of January 1, 1943, by a transfer from the capital account of Morris Harris.

The capital account of Anna Harris was debited on September 16, 1943, in the amount of \$34,083.70; and a capital account in the name of Betty Harris was credited with the same amount as of January 1, 1943, by transfer from the capital account of Anna Harris.

Entries were made in the general journal on September 16, 1943, of the same debits and credits from and to capital accounts as were made in the

four respective ledger capital accounts with the notation:

To transfer above interest in company to Albert and Betty Harris, son and daughter, one-sixteenth each, based on M. Harris' interest, \$270,049.36 and A. Harris' interest, \$275,289.73.

The business of Union Manufacturing Company was conducted during 1943 and 1944 in the same way as it had been conducted in 1942 and prior. No services were rendered to or in the business by the children, Albert and Betty, during 1943 and 1944. Neither one of the children contributed any capital of their own to the existing partnership business in 1943 or 1944, or in 1942 or prior. [77]

When, prior to 1943, Albert went to the place of business to do work of some general type which a school boy could do, after school hours and during school vacations, he was not paid any amount.

Neither Albert nor Betty withdrew any sum from the Union Manufacturing Company during 1943 and 1944. However, debits to each of their capital accounts were made at the end of 1942 and 1943 for taxes on income which was attributed to each one under bookkeeping entries made in their capital accounts. At the end of 1943 and 1944, each capital account of Albert and Betty was credited with one-sixteenth of the earnings for each year. At the end of 1943, the balance in each of the children's capital accounts was \$46,074.86.

During 1943 and 1944, the partnership, carrying on business under the name of Union Manufacturing Company, had two members only, Anna and Morris Harris. Albert and Betty Harris were not bona fide members of the partnership. There was no creation of a new and bona fide partnership of four members in 1943.

Personal income taxes for the year 1942 were paid to the State of California by Morris Harris in the amount of \$26,746.65, and by Anna Harris in the amount of \$25,256.18. Petitioners, in computing their victory tax liability for the year 1943, deducted the above amounts of California tax in their respective returns. Respondent disallowed each deduction in determining each petitioner's net income subject to 1943 victory tax.

OPINION

Harron, Judge: Anna and Morris Harris are co-partners in the partnership which conducts business as Union Manufacturing Company. The partnership, consisting of the petitioners, is not questioned by the Commissioner. [78] But respondent has determined that their son and daughter were not members of a co-partnership with petitioners, and he has taxed to petitioners income which was reported as the children's shares of the earnings of Union Manufacturing Company in 1943 and 1944. The question is whether one-sixteenth of the earnings of the above business is taxable to Albert Harris, and the same proportion to Betty Harris

as partners in Union Manufacturing Company, as petitioners contend; or whether such portions of the earnings are taxable to petitioners as part of the share of each one in the earnings of the partnership of which they are indisputably partners.

Admittedly, Albert and Betty Harris did not have capital of their own to contribute to a business venture as the contribution of partners. Petitioners allege that they made gifts of undivided one-sixteenth interests in a going business venture and that, thereupon, each child re-contributed what he is said to have received, namely, an undivided interest. Respondent does not admit that any completed gifts in praesenti were made to the children. It is pointed out that one issue presented by the pleadings is whether the alleged gifts were made. In amended petitions, each petitioner alleges, inter alia, that on January 2, 1943, he and she gave an undivided part of his and her interest to each one of the children. Respondent denies this pleading in his amended answer. It is necessary, therefore, to consider the question which is put in issue, namely, whether bona fide gifts in praesenti were made.

The petitioners contend that a partnership was created on January 1, 1943, in which each child was a co-partner, and that the partnership should be recognized for Federal income tax purposes. This question is put in issue by the pleadings of the petitioners that on January 2, 1943, the four members of the family agreed to associate them-

selves as co-partners, which [79] pleading the respondent has denied.

Petitioners state that they are familiar with the rule set forth in *Commissioner v. Tower*, 327 U. S. 280. They argue that the rule of that case, applied to the facts of this case, compel a holding that the alleged partnership of January 2, 1943, including the two children, must be recognized for Federal income tax purposes. Respondent argues that petitioners have misconstrued the rule of the *Tower* case. He cites the *Tower* case in support of his determination, and other cases where it has been applied, namely, *John G. Scherf*, 7 T. C. 346; *aff'd.*, 161 Fed. (2d) 495, certiorari denied, 68 S. Ct. 111; *M. M. Monroe*, 7 T. C. 278; *Jacob De Korse*, 5 T. C. 94; *aff'd.*, 158 Fed. (2d) 801; *W. M. Mauldin*, 5 T. C. 743; *aff'd.*, 155 Fed. (2d) 666; and *O. William Lowry et al.*, 3 T. C. 730; *aff'd.*, 154 Fed. (2d) 448, certiorari denied, 329 U. S. 725.

Petitioners are in no better position in this case than were the taxpayers in *John G. Scherf*, *supra*; *Jacob De Korse*, *supra*; and *W. M. Mauldin*, *supra*. Their contentions are not now, but have been considered, under similar facts, in many cases by this Court, and other courts. In other words, petitioners present a contention by which, in effect, they ask to have the underlying principles in this type of issue reviewed for them. We think it is unnecessary to do so, other than to point out that the question arises under section 22(a) of the Internal Revenue Code which broadly defines the

gross income which is to be taxed to an individual as including "gains or profits and income derived from any source whatever." The revenue acts do not recognize partnerships as taxable entities separate and apart from the individual partners, but provide that "Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity." [80] See section 181, Internal Revenue Code. And since the partners are liable for tax in their individual capacity, the broad scope of section 22(a) must be considered.

Here, as in the Tower case, and a line of cases which have followed in its path, two members of a family have undertaken to apportion their income among the members of the family group. In this case the arrangement purports to divide two tax units into four. The evidence fails to show that there was any intent that either one of the children would join with petitioners in "carrying on business in partnership" in the taxable years, (section 181, I.R.C.); or that there was any real change in the control over the income by the petitioners. Section 22(a) of the Internal Revenue Code is the corner stone of the Supreme Court's decision in the Tower case. Petitioners fail to understand that they have the burden of proving that something less than their respective 50 per cent shares of the income of an established business is taxable to them under sections 22(a) and 181, for they pass lightly over the matter of proving that bona fide gifts of interests were made, and of proving that

their two children were, in fact, carrying on a business with them in partnership. They miss the force of the phrase which appears at least twice in the opinion in the Tower case, which they even quote, to wit, that the issue turns on whether the junior members of the family and the senior members of the family "really intended to carry on business in partnership" in the taxable years, because they do not perceive that the Supreme Court clearly stated what factors should be shown as a matter of proof of such intent. The Supreme Court observed that: [81]

* * * A partnership is generally said to be created when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, * * * or business, and when there is a community of interest in the profits and losses. * * * A husband and wife [parent and child] may, under certain circumstances, become partners for tax, as for other, purposes. If she [the wife or child] either invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of these things she may be a partner as contemplated by * * * 26 U.S.C.A. Int. Rev. Code, pars. 181, 182.

The contention that the daughter, Betty, was a partner in the Union Manufacturing business is

particularly without merit. There is no evidence that she desired to, or intended to, or did carry on the business enterprise in partnership with her parents in the taxable years. She was about seventeen years old in 1943; she had no capital of her own; and she performed no services in the business. There is no evidence of a completed transfer of an interest in the business to her such as would put in her complete dominion and control over an interest in the business and the earnings thereof, and such as would remove from the alleged donor—mother or father—whichever claims to have made the gift (the record on this point being confused)—control over his or her purported interest and share of earnings. See *Edson v. Lucas*, 40 Fed. (2d) 398, and cases cited therein. The evidence with respect to the alleged gift to Betty is merely that if a gift were made to the son, it would be fair to make a like gift to the daughter. Whichever petitioner alleges to have made this gift intended that the interest should be retained in the business as well as the earnings, nothing to the contrary having been shown by competent evidence. We are unable to find that a bona fide gift was made to Betty of a present interest in the business. We sustain the respondent's determination that one-sixteenth of the earnings [82] attributed to her is taxable to the alleged donor, either Anna or Morris Harris.

In support of their contention that the son, Albert, was a co-partner with them in their business

during 1943 and 1944, petitioners refer us to certain cases where it has been held, upon particular facts, that a father and son were co-partners. The holdings in such cases do not provide these petitioners authority in support of their contention. Such cases are distinguishable on their particular facts. Also, *Weizer v. Commissioner*, — Fed. (2d) — (C.C.A. 6), decided January 26, 1948, is inapposite, the facts being quite different.

Albert had an ambition to go into his father's business. He had done various things about the plant and office, without pay, during vacations and after school prior to 1943. But none of his activities, considering his youthful age and consequent limitations, had been sufficiently substantial to have taken him into any substantial or important work in the business before 1943. Cf. *John G. Scherf*, *supra*. In 1943 and 1944, his absence, therefore, was not absence from a business activity in which he had previously rooted himself. Therefore, little weight can be given his casual activities at his father's "shop" as a school boy, and full weight must be accorded the fact that he rendered no services whatsoever during 1943 and 1944. See *M. M. Monroe*, *supra*.

Albert contributed no capital to the Union Manufacturing Company business originating with himself. Furthermore, the evidence is not present to show that the purported gift to Albert of an interest in the business was a completed gift in *praesenti* which vested in him complete dominion

and control over an interest in and earnings of the business. *Edson v. Lucas*, *supra*. There was no written partnership agreement. The alleged verbal [83] agreement was a loose one. There is no evidence to clearly show that the usual terms of a partnership agreement were worked out so as to definitely establish the rights and duties of the son if he were to really carry on a business in partnership with his parents during the taxable years. The only inference which can be made from the record is that management of the business was to remain in Morris Harris, and that he was to continue to control the business and the earnings, as far as his children might be concerned. Partnership books were not closed. There were only bookkeeping entries which served to provide the basis for allocating earnings to the young son who was in school, at first, and later in the Army.

Upon consideration of all of the facts, we cannot find that Albert was a bona fide co-partner in the business in 1943 and 1944. Applying the rationale of the *Tower* case, we sustain respondent's determination. See *John G. Scherf*, *supra*.

The second question is whether state income taxes are deductible in computing victory tax net income.

Section 172(a) of the 1942 Revenue Act enacted a new tax called the victory tax which was to be levied upon income in years beginning after December 31, 1942. Section 172(a) of the 1942 Revenue Act added new provisions to the Internal

Revenue Code, sections 450 to 456. These provisions of the Internal Revenue Code provided for the computation of the new tax without reference to Chapter 1—Income Tax, of the Internal Revenue Code excepting where the statutory provisions relating to the computation of net income for the income tax were specifically made to apply by cross-reference. That is to say, the computation of the income tax and the computation of the victory tax are separate, the first being covered by [84] Subchapters A, B and C; and the second being covered by Subchapter D. For example, section 21 of the Internal Revenue Code (Subchapter B, Part 1) defines “net income” for purposes of the income tax; and section 451 of the Internal Revenue Code (Subchapter D—Part 1) defines “victory tax net income.” Also, the respective Subchapters make specific provisions for the various types of deductions which are allowable in computing “net income” and “victory tax net income.”

It must be kept in mind that all deductions are a matter of legislative grace. The question which is now raised by the petitioners under the victory tax net income provisions of the Internal Revenue Code must be considered upon the basis of the specific statutory provisions which allow deductions. Section 451(a)(3) states what taxes may be deducted in computing “victory tax net income.” The provision is as follows:

Section 451. Victory Tax Net Income.

(a) Definition.

* * * *

(3) Taxes—Amounts allowable as a deduction by section 23(c), to the extent such amounts are paid or incurred in connection with the carrying on of a trade or business, or in connection with property used in the trade or business, or in connection with property held for the production of income.

The subsection above quoted contains a limitation. First there is cross-reference to section 23(c) of the Internal Revenue Code which relates to the deduction of taxes generally for the purpose of computing "net income." Under section 23(c) there is the general provision that taxes paid or accrued within the taxable year are deductible, but the exceptions to the general rule are set forth. Income taxes paid to a state are not within the exceptions, and they are deductible in computing net income for the income tax [85]

However, the limitation contained in section 451 (a)(3) is that only those taxes which are deductible under section 23(c) which "are paid or incurred in connection with the carrying on of a trade or business, or in connection with the property used in the trade or business, or in connection with property held for the production of income" may be deducted for the purpose of computing the victory tax net income.

It is our understanding that the California income tax is a personal income tax which, like the Federal income tax, is imposed upon income de-

rived from all sources. Petitioners do not cite any cases which give contrary construction of the California statute. We do not have the personal income tax returns of the petitioners in evidence, neither the state nor the Federal returns. It is assumed that most of the income of the petitioners which was reported for both state and Federal income tax was derived chiefly from the partnership business. Petitioners argue that the state income tax was a tax which was paid or incurred in connection with the carrying on of a business within the meaning of section 451(a)(3) because the income which was taxed by the state was derived from a business.

The construction which the petitioners would have placed upon section 451(a)(3) does not, in our opinion, give proper consideration to the wording of the pertinent section. The state income tax was not incurred "in connection with the carrying on of the business." Those words have a clear meaning, but, if it is necessary to undertake to clarify them, we think that the words mean a tax which is incurred as an incident to the carrying on of business in the sense that a business expense is incurred in carrying on a business; that is to say, something which must be paid in order to do business. [86]

The specific question raised by petitioners is covered by a ruling of the Commissioner, I.T. 3644, which comes to the conclusion that "the personal income taxes imposed by the various states are not

deductible in whole or in part in computing victory tax net income under section 451(a)(3) of the Internal Revenue Code, *supra*." We think this ruling is correct and that the report of the Committee on Finance of the Senate, which accompanied the Revenue Bill of 1942, supports the Commissioner's ruling. See C.B. 1944, p. 373; Senate Report No. 1631, 77th Congress, 2d Session; C.B. 1942-2, 504, 509.

Petitioners think that the ruling set forth in I.T. 3644 may be in conflict with another ruling of the Commissioner, I.T. 3829, C.B. 1946-2, p. 38. The latter ruling was made in connection with the deductions allowed for the purposes of computing adjusted gross income under section 22(n)(1) of the Internal Revenue Code. That section relates to the income tax. We think that the ruling made under I.T. 3829 does not apply in making an interpretation of section 451(a)(3) which relates to the computation of victory tax net income. It has been noted before that state income taxes are deductible for the purpose of computing the income tax, and the ruling in I.T. 3829 is consistent with the statutory allowance of deduction for state income tax. The crux of the matter is that the Congress did not see fit to permit deduction of state income taxes in the computation of the [87] victory tax net income for the purpose of the victory tax.¹

¹ See Senate Report No. 1631, 77th Congress, 2d Session; C.B. 1942-2, p. 509, where the following is stated:

Since the victory tax does not allow any deduc-

We think that this is a complete answer to the petitioner's contention.

Reviewed by the Court.

Decisions will be entered for the respondent. [88]

The Tax Court of the United States
Washington

Docket No. 12984

ANNA HARRIS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated on May 12, 1948, it is

Ordered and Decided: That there are deficiencies in Federal income and victory tax for the years 1943 and 1944 in the respective amounts of \$5,-662.73 and \$18,136.67.

Enter May 12, 1948.

(Seal) /s/ MARION J. HARRON,
Judge.

[89]

tion for state income taxes your Committee deemed it advisable to provide that the total income tax and victory tax should not exceed 90% of the taxpayer's net income * * *.

The Tax Court of the United States
Washington

Docket No. 12985

MORRIS HARRIS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated on May 12, 1948, it is

Ordered and Decided: That there are deficiencies in income and victory tax for the years 1943 and 1944 in the respective amounts of \$6,035.87 and \$18,693.10.

Enter May 12, 1948.

(Seal) /s/ MARION J. HARRON,
Judge.

[90]

The Tax Court of the United States

Docket No. 12984

ANNA HARRIS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 12985

MORRIS HARRIS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Court Room No. 229,

United States Post Office and Court House Bldg.,

Los Angeles, California

January 29, 1948—9:30 a.m.

(Met pursuant to notice.)

Before: Honorable Marion J. Harron, Judge.

Appearances: D. Webster Egan, 403 West 8th Street, Los Angeles, California, appearing for the Petitioner. Dana Latham, 411 West 5th Street, Los Angeles, California, appearing for the Petitioner. [92] T. M. Mather. (Honorable Charles Oliphant, Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent. [93]

PROCEEDINGS

The Court: Docket Nos. 12984 and 12985, Anna Harris and Morris Harris. Will counsel please state appearances for the record.

Mr. Egan: D. Webster Egan. Your, Honor, the Petitioner wishes to add the name of Mr. Dana Latham, as associate counsel.

Mr. Mather: Mr. Mather, for the Respondent.

The Court: Proceed, Mr. Egan.

Mr. Egan: Your Honor, these deficiencies, most of them at least, come about by reason of the following: That on or about January 1st or 2nd, 1943, the Petitioners filed herein were co-partners in a manufacturing company, co-partnership. About that time they transferred, each to two minor children, an undivided sixteenth interest in and to the property and assets of the co-partnership. We believe that the evidence will show that there was no restrictions whatsoever on these gifts and further that there was no charges made against the minor's accounts for support, maintenance or education.

The other issue in the case concerns the question of charging to expense, in the year 1943 on petition of Morris Harris' return, the sum of \$26,747.65. as a deduction for the purpose of computing the victory tax. In the case of Anna Harris, her charge was \$25,256.18, as a deduction against the computing of the victory tax, these two amounts being income [96] taxes paid to the State of California. We believe that these two amounts are proper charges against the business income of both of these Petitioners.

Mr. Mather: If your Honor please, at this time I would like to move that the cases be consolidated.

The Court: Motion granted.

Mr. Mather: As stated by counsel for the Petitioner, those are the two issues. Under the pleadings, there is no issue with respect to any partnership; merely the validity of a gift by the partners, these Petitioners, to their children of a one-sixteenth interest in their business.

The petition alleges that the Petitioners were partners, operating under the firm name of Union Manufacturing Company, and that allegation is admitted. It also alleges that they made a gift to their children of a one-sixteenth interest, and that is denied.

With respect to the other issue, the deduction of state income taxes in determining the victory tax net income, the position of the Respondent is that there is no statutory provision allowing that deduction, and that the legislative history of Section 451, of the Code, specifically precludes the deduction.

Mr. Latham: If your Honor please, I don't know what Mr. Mather had in mind regarding his statement that there was no issue with respect to the validity of this partnership for [97] tax purposes. The petition recites that the Respondent proposes to add the taxpayer's net income for the year 1944, and also a different amount for year 1943, a certain amount being the amount of the income of certain of the children, and recited as having been received by the children from their interest in the partnership.

Now, it is true that there is no specific statement in the statement of facts, to the effect that these people were partners, but that at best would be merely a conclusion of law, it seems to me.

The Court: I think Mr. Mather means, we do not have in this case the question of whether Morris Harris and his wife, Anna Harris, carried on a business in partnership, under the name of Union Manufacturing Company.

Mr. Latham: There is no issue with respect to that point.

The Court: That issue has been raised in a good many cases and Mr. Mather just wanted to point out that we do not have that issue in this case.

Mr. Latham: That is what I had in mind. Might I say this, your Honor—

The Court: Let me finish. We had a history of cases, as you know, where the taxpayer, husband or wife, carried on a business with them in partnership. In this case the Respondent has not determined that Anna Harris is not a member of a [98] bona fide partnership. He did not determine that. You, in your petition, allege perhaps that there was a partnership, but whether you did or didn't, there is not a question about the property right of Anna Harris reporting, at least, or at the most, one half of the net income of the Union Manufacturing Company.

Now, you have come to the matter of a husband and wife, who carry on a business in partnership and either or both give an undivided interest to a child. Now, do you mean that you would understand that to raise a question of whether the child

was a member of the partnership, that could be a question in the case?

Mr. Latham: That is my understanding of Mr. Mather's point.

The Court: Supposing you state your contention, please, the Petitioners' theory and let Mr. Mather worry about the Respondent's theory.

Mr. Latham: The Petitioners' theory is that the gift of an interest in the assets of a going partnership, was made to each of the children, and at the same time, a partnership was created, in which the children were partners.

The Court: That would be a matter you would have to prove.

Mr. Latham: That is correct.

The Court: Were there one or more children?

Mr. Latham: Two.

The Court: What were their names?

Mr. Latham: Albert P. and Betty.

The Court: Do the Petitioners contend that each was given a one-sixteenth, or both?

Mr. Latham: Each.

The Court: What do you intend to show as to the making of gifts; who made these gifts?

Mr. Latham: One parent made a gift to one child and the other to the other.

The Court: Who did it?

Mr. Latham: Mr. Harris made a gift to his daughter, Betty, and Mrs. Harris made a gift to her son, Albert.

The Court: All right. What else does the Petitioner intend to show?

Mr. Latham: We intend to show participation in the activities of the partnership by the son and show the circumstances leading up to the formation of the partnership.

The Court: Now, are you contending that the partnership consisted of four people, or that the partnership consisted of two?

Mr. Latham: That the partnership consisted of four people.

The Court: That is the Petitioners' contention.

Mr. Latham: That is the Petitioners' contention. [100]

Now, there has never been any question but what a partnership existed between Mr. and Mrs. Harris.

The Court: That is my understanding. The issue in the case is, whether a partnership existed among Mr. & Mrs. Harris and Albert and Betty Harris.

Mr. Latham: That is correct.

Mr. Mather: That is correct, your Honor, but there is no allegation that the children were partners in the pleadings.

The Court: I see.

Mr. Egan: If your Honor please, the facts allege that each child received an undivided one-sixteenth interest in and to the assets of Union Manufacturing Company, which is a co-partnership. Now, to allege they were partners, would simply be a conclusion of law.

The Court: Well, perhaps not where you have a tax question, Mr. Egan.

Mr. Egan: Well, the Commissioner is pretty

technical on some of these things. As a matter of pleadings, it would be a conclusion of law.

The Court: This is a specialized field that we work in, and that is a technical point, but I would be inclined to agree with Mr. Mather, that the pleadings ought to cover that. You should not rest on the fact of the transfer of the interest in and of itself. [101]

Mr. Egan: Don't you think that is a matter of evidence? As I say, if I were to allege they were co-partners, it would be simply a conclusion of law.

The Court: I do not think so, because the issue for tax purposes, whether you have a partnership relation so that the income of a business or property is taxable to various people, which you contend are partners, is a particular kind of issue that requires the introduction of particular evidence. I think your pleadings will be clearer if you set forth that you contend the children were members of the partnership. We will assume that that is what your pleading means, and I think we do not need to spend any more time discussing this particular matter.

Mr. Latham: May we have leave to file amended petitions within ten days?

The Court: Certainly. It is all right to have the question raised. If there is any doubt about the pleadings, the question should be raised at the trial.

Mr. Mather: If your Honor please, I have no objection to such amendment. I would like to

state, in connection therewith, that the evidence will show that these gifts, if they were gifts, emanated from the parents to their children, and there was no contribution of capital by the children, emanating from themselves, to any partnership; that it is the position of the Respondent, that the evidence will show that the [102] children were minors at the time, and that no services were performed by the children.

The Court: Are you ready to proceed?

Mr. Latham: Yes, your Honor. By agreement with Mr. Mather, subject to your approval, and in the interest of speeding this case, we will be a little informal on introduction of certain documents and evidence.

With respect to issue number one, namely the deductibility of the California State income tax, in determining victory tax net income for the year 1943, I offer in evidence this docket, 12984, as Petitioners' Exhibit No. 1, a retained copy of Morris Harris' 1942 California State income tax return.

Mr. Mather: No objection.

Mr. Latham: This shows a tax due of \$26,746.65, and I believe it may be stipulated that that amount was paid by Mr. Harris to the State of California, during the calendar year 1943.

Mr. Mather: I think it is admitted in the pleadings.

The Court: Received as Petitioners' Exhibit 1.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 1.)

[Petitioners' Exhibit No. 1 is set out in full, page 130, of this printed Record.]

The Court: Since the cases are consolidated, you do not have to refer to the docket number.

Mr. Latham: That only applies to Morris Harris. All the other evidence will apply to both cases?

The Court: No. When your cases are consolidated your evidence applies to the consolidated proceedings, and you are just wasting time referring to the different dockets.

Mr. Latham: All right. As Petitioners' Exhibit No. 2, the retained California State income tax return of Anna Harris for the calendar year 1942, showing a tax of \$25,256.18, which may be stipulated was paid to the State of California during the calendar year 1943.

Mr. Mather: No objection.

The Court: Received as Exhibit 2.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 2.)

[Petitioners' Exhibit No. 2 is set out in full, page 134, of this printed Record.]

Mr. Latham: Mrs. Harris, take the stand, please. Whereupon,

ANNA HARRIS,

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, please.

The Witness: Anna Harris.

(Testimony of Anna Harris.)

Direct Examination

By Mr. Latham:

Q. Will you state your name for the record, please? A. Anna Harris.

Q. Your address? [104]

A. 13098 Sunset Boulevard, Los Angeles.

Q. You are one of the Petitioners in this proceeding? A. Yes.

Q. Are you connected with the Union Manufacturing Company of Los Angeles? A. Yes.

Q. In what capacity? A. A partner.

Q. State briefly, for the Court, your connection with that concern, from the beginning to the present, very briefly.

A. Well, the partnership was formed in 1909 and I used to go there to work after school. I attended high school at that time and continued until I finished high school and after that I put in my full time.

Q. Who were the partners in 1909?

A. Mr. Harris and my father, Mr. Pinkert.

Q. By Mr. Harris you mean your husband?

A. Well, my husband now.

Q. Proceed.

A. Then, after I finished high school, I continued and put in my time, and in 1919 Mr. Harris and I were married. I continued right in the business, doing practically everything outside of manufacturing the materials that were manufactured. I took care of the credits in the office, the book-keeping, the correspondence, waited on the trade

(Testimony of Anna Harris.)

who came into the place and, [105] well, just about did everything, for my father and Mr. Harris.

Q. State the nature of the business of the partnership.

A. It is a manufacturing business of work and outing clothing.

Q. Has it been that type of business during the entire period?

A. Yes, but it grew and grew and as it grew, we engaged bookkeepers, stenographers and what not. My capacity was much more executive then. With all the work, plus bookkeeping, very often I was so busy I had to take my bookkeeping home. I worked day and night, practically, before that. My father took care of the outside selling and my husband took care of the inside manufacturing. I did all the rest. That is the way we worked until practically up to date. I am not active now, but I was for many, many years.

Q. How long did the partnership between your husband and your father continue?

A. Until '23, I believe. Until the end of '23; about 14 years.

Q. Then what happened?

A. My father stepped out and I became a partner. My father retired.

Mr. Latham: I offer as Petitioners' Exhibit 3, photostatic copy of a partnership agreement between Morris Harris and the witness, Anna Harris, dated January 2, 1924. [106]

Mr. Mather: No objection.

The Court: That will be marked and referred

(Testimony of Anna Harris.)

to as Petitioners' Exhibit 3. Received in evidence.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 3.)

[Petitioners' Exhibit No. 3 is set out in full, page 137, of this printed Record.]

By Mr. Latham:

Q. Mrs. Harris, I show you this document and ask you if you know what it is.

A. Yes, that is our partnership agreement.

Q. That partnership agreement, between your husband and yourself, actually was executed on the date it bears?

A. Yes, that is right.

Q. Did you continue to give your full time, or practically full time, to the affairs of the partnership after January, 1924?

A. Well, not my full time, but a great deal of the time, because I had a child at that time. I kept in very close touch to it and gave a good deal of my time, but not as much as I did before.

Q. You actually went directly to the office of the company?

A. Oh, yes, I did and gave a lot of time to it.

Q. Did you perform the same general type of services that you performed prior to 1924?

A. Yes. [107]

Q. You have two children?

A. Yes.

Q. Will you state their names and ages, birth dates?

A. Albert Harris, born June 14, 1923 and Betty Harris, born September 22, 1926.

(Testimony of Anna Harris.)

Q. Your son, Albert, is in the courtroom?

A. That is right.

Q. I show you another document, purporting to bear on its face, the date, April 1, 1937, and ask you to state what it is.

A. I imagine that is a renewal of the partnership between myself and Mr. Harris.

Q. In other words, the first agreement of 1924, provided for a ten-year term?

A. That is right, and that is the renewal.

Q. Was this signed at the suggestion of your then attorney? A. That is right.

Mr. Latham: I will offer in evidence, as Petitioners' Exhibit No. 4, photostatic copy of partnership agreement between Morris Harris and Anna Harris, dated April 1, 1937.

Mr. Mather: No objection.

The Court: Received as Exhibit 4.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 4.) [108]

By Mr. Latham:

Q. How long did you continue to operate under this second partnership agreement between yourself and your husband?

A. Well, until we made the change—you mean taking in the children?

Q. Yes. A. Until January, 1943.

Q. Now, please state the events leading up to

(Testimony of Anna Harris.)

this change in 1943, which you have just referred to.

A. Well, along about 1937, it seemed we noticed an interest in Albert to join our business. Of course, he was just a little fellow of about 14, but Mr. Harris had received a letter from someone offering to buy our business, and he was more or less interested in selling it because he thought we would like to retire, but Albert was very much opposed to that and said he had always hoped to go into this business with his father, when he was old enough. So, for that reason, Mr. Harris gave up the idea of ever selling it and waited until such time as Albert would be old enough to join him. But when he graduated from high school he didn't want to go to college. He wanted to go into the business. We wanted him to have more education—

Q. When did he graduate from high school?

A. In '40 or '41. I don't remember exactly, but we prevailed upon him to continue and go to college, because we felt [109] he would be worth more to the business if he had more education.

Then he came home from college; he went to the University of Virginia, that summer.

Q. Just when did he enter the University of Virginia?

A. Must have entered it in the fall of '40, '41, I think, but he came home.

Q. What kind of a course was he taking?

A. Just a general educational course, and when he came back, that summer—

(Testimony of Anna Harris.)

Q. Now, that is the summer of '42?

A. '42. He worked in the factory in all the various departments. He seemed to be very interested, sort of just taking it all in. He made up his mind then and there that that was the thing he would rather do, than even go to school, so that summer he took a night course at U.S.C., on textiles. Then, we prevailed upon him to go back to college. He changed colleges because the University of Virginia didn't offer the course that would be suitable for his training in textiles, and he went to the State University of North or South Carolina—Raleigh—because that school offered the course that was suitable for his business.

We then decided that he would follow that, and just by way of inducement, we wanted to give him a small interest in the business. We talked it over then and decided that was [110] the way it would be.

Q. Did you then give him this sixteenth interest in the partnership assets, of which you were a partner, pursuant to the statement that has been made heretofore?

A. Well, we did, beginning in 1943, beginning in January. That is the way we thought it would be a good idea to do.

Q. With whom was that gift and the formation of the new partnership discussed?

A. Well, we discussed it with Albert before he went back to school, and then he came back at Christmas time and we discussed it some more, be-

(Testimony of Anna Harris.)

cause I think we had seen Mr. Egan about it, to see just how we could do it.

Q. Your attorney? A. Yes.

Q. Was it also discussed with Mr. Harris and with Betty?

A. Oh, yes, we all discussed it, yes.

Q. So that— A. We also—pardon me.

Q. Go ahead.

A. We also felt that as long as we were giving Albert a small share, just having the two children, we felt it would be fair to give Betty the same share, and although she was very young, she always showed an interest. We felt that after her college, if she wasn't married, she would step in.

Q. She had not and did not work in the business as Albert did?

A. No, but she showed an interest.

Q. Is it a fair statement, that Christmas of 1942, before Albert returned to college, it was clearly understood between the four of you, that this partnership was to go into effect as of the 1st of January, 1943? A. Yes.

Q. Was there ever any writing, evidencing this new partnership?

A. What do you mean by that?

Q. Was it ever reduced to writing, such as was the case in the prior partnership?

A. Yes, it was. Later in the year; we didn't do it right away.

Q. Now, you never did have an actual agreement? A. No, we had no agreement.

Q. That is, in writing, I mean. A. No.

(Testimony of Anna Harris.)

Q. Why was that?

A. Well, I guess because we are just lax about those things. We felt that as long as we had decided to have the partnership, that that was all there was to it; that, actually, if we gave them that share, it was a partnership. We just neglected to do it. [112]

Q. Isn't it a fact, that Mr. Egan advised you that a writing was not necessary, a written agreement was not necessary?

A. I don't remember, excepting that I assumed that. Yes, I think that is the way we thought it should be done.

Q. Now, in connection with this oral agreement between the four of you, was there any restrictions between you with respect to the rights of the children, either as to activities or withdrawals from the partnership?

A. No, none at all.

The Court: Are you offering in evidence any written agreement of the partnership?

Mr. Latham: There was none, your Honor, with respect to this particular partnership, upon the advice of Mr. Egan, whom we will put on the stand if necessary.

The Witness: That is right.

By Mr. Latham:

Q. Now, what kind of work—

The Court: Excuse me, please. What evidence of partnership was there?

Mr. Latham: The understanding of the parties, followed by the appropriate book entries, which will

(Testimony of Anna Harris.)

be offered in evidence, the filing of partnership tax returns and so forth and then there also—

The Court: Was that an oral arrangement?

Mr. Latham: This one was an oral arrangement, and confirmed in writing later by a subsequent partnership agreement, which my office drew in 1947, when the interest of the parties were changed, due to the purchase of Albert of a small additional interest in 1946.

The Witness: That is right.

Mr. Latham: Now, that interest in 1946, is not here involved because we are only dealing with the years 1943 and 1944, but we did suggest to Mr. and Mrs. Harris and Albert, that the present understanding, or the one that had been in effect since 1943, should be reduced to writing, which was done.

The Court: What evidence of a gift was there?

Mr. Latham: We have the gift tax return, which we propose to offer in evidence.

The Court: That is the only evidence of a gift?

Mr. Latham: Well, plus the book entries. I don't know what other evidence is possible. The statement of the partners—I can't think of any other evidence that would be available, under any circumstances.

The Court: There could be. I just was inquiring. All right. Go ahead.

By Mr. Latham:

Q. You say, that Albert worked throughout the summer of 1942 at the plant? [114]

A. That is right.

Q. In various departments of the business?

(Testimony of Anna Harris.)

A. Yes, all around; making a general survey of everything.

Q. Becoming familiar with the operation of the business? A. That is right.

The Court: Well, now, how long a period would that be, Mrs. Harris?

The Witness: Well, I don't know just when he got out of school, but it would be until the following term. I imagine it was June.

The Court: College vacation usually runs for about two and a half months?

The Witness: About three months, June, July and August. Something like that.

The Court: All right.

By Mr. Latham:

Q. Prior to the summer of 1942, had Albert done any work in the business?

A. Yes, he worked after school, when he went to high school, and on Saturdays.

Q. And a portion of the summer vacation?

A. Yes.

Q. During the summer of 1942, did Albert draw any salary [115] or pay from the business?

A. No, he didn't.

Q. Will you state to the court why he did not?

A. Well, because it would entail a social security number and a lot of other things that are important when people work, and we felt it was unnecessary for him because eventually we felt it would be a partnership and he wouldn't need it, also he really didn't need the money; we took care of him. We

(Testimony of Anna Harris.)

felt too that perhaps the employees wouldn't think it was right, that as long as there was work to be done, that perhaps someone who needed the money more than he did should have it.

So, we didn't pay him anything.

Q. Now, what happened when Albert returned to the textile school at North Carolina? After the Christmas vacation of 1942.

A. Well, he enlisted very soon afterward in the E.R.C.; in December, I think, of that year. He felt he would be called very soon, and he preferred to enlist, rather than be drafted.

Q. When was he called into service?

A. April of the following year; the following April, I would say.

Q. April of 1943? A. That is right.

Q. When did he return from the service?

A. In July, 1945—no, not from the service, he returned in January, 1946. [115]

Q. He was discharged at that time?

A. He was not discharged then, but he came back from overseas in July, 1945.

Q. What did he do immediately upon his discharge?

A. He started to work immediately. We thought he should have a little vacation, but he went to work.

Q. Right to work in the business?

A. That is right.

Q. Has he worked continuously in the business from that time to the present?

(Testimony of Anna Harris.)

A. Yes. He has never had any time off either.

Q. In what capacity?

A. Well, in the general capacity, executive. He is a great help to Mr. Harris in every way. All the things he would do, he is letting drop off on Albert, because he needs that help.

Mr. Latham: Will it be stipulated that appropriate Federal partnership returns were filed for the years in question, in which the four individuals here mentioned, were named as partners?

Mr. Mather: Well, no, I couldn't stipulate that appropriate returns were filed, Mr. Latham.

Mr. Latham: Shall we say, the Form 1065?

Mr. Mather: Partnership returns were filed for the partnership, in which, for 1943 and 1944, in which a [117] distributive share of the partnership income is shown as being allocated to the children, and that the children filed, or I should say, that returns were filed for the children, signed by their mother, for 1942 and 1943.

Mr. Latham: 1943 and 1944.

Mr. Mather: Yes.

Mr. Latham: I am not asking you to stipulate that they are partners, I am just asking you to agree that the Form 1065, which is the Federal partnership return, was filed for the years 1943 and 1944, in which Albert and Betty Harris were shown as receiving one-sixteenth interest in the partnership income.

Mr. Mather: They were shown as—

The Court: I think we had better have the re-

(Testimony of Anna Harris.)

turns in evidence, Mr. Mather. Do you want to offer them?

Mr. Latham: I would like to offer them. I will offer in evidence as—

The Court: Will you offer them, Mr. Mather, so they could be photostated in Washington?

Mr. Mather: I will request they be withdrawn and have photostats made.

The Court: You make that request.

Mr. Mather: I don't care to offer them myself.

Mr. Latham: I offer as Petitioners' Exhibit, I believe, No. 5 and 6, original partnership returns for the [118] calendar year 1943 and 1944, of the Union Manufacturing Company, 5S 1943 and 6S 1944.

Mr. Mather: No objection, your Honor. I would like to have the record show that those original partnership returns were produced from the Government file, and ask leave to withdraw them for substitute photostats.

The Court: That may be done. The returns are received as Exhibits 5 and 6.

(The documents above-referred to were received in evidence and marked Petitioners' Exhibits 5 and 6.)

[Petitioners' Exhibits No. 5 and 6 are set out in full, pages 139, 143, of this printed Record.]

Mr. Latham: I offer as Petitioners' Exhibit 7, a gift tax return, Form 709, by Anna Harris, covering the year 1943.

Mr. Mather: No objection.

The Court: Received as Exhibit No. 7.

(Testimony of Anna Harris.)

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 7.)

[Petitioners' Exhibit No. 7 is set out in full, page 149, of this printed Record.]

Mr. Latham: As Petitioners' Exhibit 8, donee's gift tax return by Albert P. Harris and that is Form 710.

The Court: Is his name Albert, A-L-B-E-R-T or E-L-B-E-R-T?

Mr. Latham: Albert—for the year 1943.

The Court: Received as Exhibit 8.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 8.)

[Petitioners' Exhibit No. 8 is set out in full, page 151, of this printed Record.]

Mr. Latham: As Petitioners' Exhibit 9, gift tax return for the year 1943, Form 709, of Morris Harris.

Mr. Mather: No objection.

The Court: Received as Exhibit 9.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 9.)

[Petitioners' Exhibit No. 9, see page 152, of this printed Record.]

Mr. Latham: As Exhibit 10, donee's gift tax return, for the year 1943, Betty Harris, donee, Form 710.

Mr. Mather: No objection.

The Court: Received as Exhibit No. 10.

(Testimony of Anna Harris.)

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 10.)

[Petitioners' Exhibit No. 10, see page 152 of this printed Record.]

Mr. Latham: And as Petitioners' Exhibit No. 11, photostatic copy of a Treasury Department letter, dated September 25, 1945 referring to the various gift tax returns just mentioned, increasing the valuation named and proposing an additional gift tax.

Mr. Mather: That is objected to as irrelevant and immaterial.

Mr. Latham: I think it is pertinent. It shows that the Treasury Department did recognize and act upon these various gift tax returns which we have just referred to.

The Court: Received as Exhibit 11.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 11.)

[Petitioners' Exhibit No. 11 is set out in full, page 152, of this printed Record.]

The Court: May I say, Mr. Latham, that we have held frequently that the termination of deficiency in a gift tax, is not material in determining the taxability of income in business.

Mr. Latham: I am fully familiar with that, your Honor. I simply make the observation as to what evidence we have that a gift, in fact, has been made. This is merely adding to that point.

(Testimony of Anna Harris.)

The Court: Mr. Egan's point, which he raised at the beginning, goes right to the heart of this issue.

Mr. Latham: We make no contention—

The Court: You see, you can make a gift. You can do a great many things that you want to do, but whether or not that will alter the relations and income, if I may put it that way, is the question that is involved in this case.

Mr. Latham: As a matter of fact, if I understand you, Mr. Mather, you conceded that the gift was, in fact, made, do you not?

Mr. Mather: No, I do not.

Mr. Latham: I think your answer concedes it.

Mr. Mather: I don't believe so. It specifically denies it.

Mr. Latham: All right.

By Mr. Latham:

Q. Mrs. Harris, I show you another document and ask you [121] to state what it is.

A. Yes. This is the partnership of all of us, after Betty and Albert were included.

Q. What is the date of this document?

A. May 20, 1947.

Q. Will you please state the circumstances—does that document bear your signature?

A. Yes, it does.

Q. Are those the signatures of Morris, Betty and Albert? A. Yes. All of them.

Q. Will you please state the circumstances under which the document was prepared and executed?

(Testimony of Anna Harris.)

A. Well, I consulted your office about some of our affairs and in the course of the conversation, you found out that we had no partnership agreement with the children. You thought it was necessary to have it. We didn't think it was and didn't have it.

Q. You mean, no partnership agreement in writing?

A. A written partnership agreement, yes.

Q. My office suggested your oral agreement be reduced to writing?

A. That is right, and you drew it up for us.

Mr. Latham: I will offer in evidence as Petitioners' Exhibit 12, the document which has been identified by this witness and which is dated May 20, 1947. [122]

Mr. Mather: That is objected to as irrelevant and immaterial. Taxable years are 1943 and 1944 and any arrangement that they might have had in subsequent years, would have no bearing on the issues involved in this proceeding.

The Court: Ojection sustained.

Mr. Latham: Could I be heard on that, if your Honor please?

The Court: Surely.

Mr. Latham: These partnership cases, as I understand it—the Government takes the position that the entire record should be looked at, in order to determine the intent of the parties; what actually happened and that sort of thing. Some question has been raised, I think, by your Honor, as to what

(Testimony of Anna Harris.)

evidence we had and while this, at best, may be deemed self-serving, it does seem to me a part of the complete picture just as the original partnership agreement, back in 1924. That, technically speaking, could have been objected to but was not, as being too early. It seems to me the relations of these parties, from the beginning to the present are all pertinent in determining whether or not a true partnership existed.

The Court: Mr. Latham, in these cases, the standard to be applied has now been settled by the Supreme Court, and under the rules, the evidence to be introduced must relate to the taxable year involved, or the preceding years. Now, [123] it has been testified by Mr. Harris that there was an agreement drawn up subsequently, and that is sufficient. It is not material to the year 1943, to have the agreement in evidence; terms of the agreement or anything else.

Mr. Latham: In the interest of speed, we will be just a little bit informal, if we may, your Honor please.

The Court: Well, don't hurry. I was hearing a case but I put it over now until 2:30 this afternoon. You have all the time you want.

Mr. Latham: I offer as Petitioners' Exhibits 12 and 13, original pages from the ledger of the Union Manufacturing Company, showing the capital accounts of Albert Harris and Betty Harris, the account of Albert Harris being No. 93 and that of Betty Harris No. 94, with the request, if your

(Testimony of Anna Harris.)

Honor please, that I may be permitted to substitute photostats for these originals.

The Court: I think all the capital accounts should be introduced.

Mr. Latham: I will be glad to. I have all four here.

The Court: You may withdraw and substitute photostats.

Mr. Latham: Then, Exhibit No. 14 will be the capital accounts.

The Court: It is very much better for you to offer [124] each page and say what it is. It shows up in the record, and it is easier for the court.

Mr. Latham: No. 12 will be, then—

The Court: Will be the next one.

Mr. Latham: The capital account of Morris Harris, one of the Petitioners, account No. 91.

The Court: Received as Exhibit 12.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 12.)

[Petitioners' Exhibit No. 12 is set out in full, page 154, of this printed Record.]

Mr. Latham: And as Exhibit 13, capital account of Anna Harris, account No. 92.

The Court: Received as Exhibit 13.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 13.)

[Petitioners' Exhibit No. 13 is set out in full, page 155, of this printed Record.]

(Testimony of Anna Harris.)

Mr. Latham: No. 14, that of Albert Harris, account No. 93.

The Court: Received as Exhibit No. 14.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 14.)

[Petitioners' Exhibit No. 14 is set out in full, page 156, of this printed Record.]

Mr. Latham: Exhibit 15, account No. 94, Betty Harris.

The Court: Received.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 15.)

[Petitioners' Exhibit No. 15 is set out in full, page 157, of this printed Record.]

Mr. Latham: I might state, that these began in 1942 [125] so far as Mr. and Mrs. Harris are concerned, and 1942 as far as the children are concerned. There will be no occasion to go back of those dates.

The Court: Are you going to ask the bookkeeper or an accountant to testify?

Mr. Latham: Not unless Mr. Mather or the Court desires. We have the bookkeeper here.

I would also like the record to show that I hold in my hand, the Union Manufacturing Company's general journal. There appears on page 40—

The Court: What are you going to do; are you going to read into the record the entries?

Mr. Latham: One entry, if your Honor please, which Mr. Mather is interested in.

(Testimony of Anna Harris.)

The Court: I think you should ask the accountant to testify.

Mr. Latham: Then, I may ask Mrs. Harris to step down and put the bookkeeper on the stand?

The Court: I don't think that is necessary. You can have your accountant come in later.

Mr. Mather: This is just one item in the journal which if Mr. Latham won't offer, I will have to.

The Court: Will you stipulate?

Mr. Mather: I will be very happy to.

Mr. Latham: We will stipulate that on page 40 of the [126] general journal, the following shows:

"1943: September 16, 1943, 1/1/43, M. Harris, Capital account, page 91, \$34,083.70."

Immediately below that:

"A Harris, Capital account No. 92, \$34,083.70."

Below that:

"Albert Harris, Capital account No. 93, \$34,083.70."

And below that:

"Betty Harris, Capital account No. 94, \$34,083.70," with the statement: "To transfer above interest in company to Albert and Betty Harris, son and daughter, one-sixteenth each, based on M. Harris' interest, \$270,049.36 and A. Harris' interest, \$275,289.73."

Then, those figures are added together, making a total of \$545,339.09. That completes the entry just stipulated.

The Court: What is that total figure?

Mr. Latham: Total of two prior capital accounts of Mr. and Mrs. Harris.

(Testimony of Anna Harris.)

The Court: That is page 40 of the general ledger?

Mr. Latham: Page 40, general ledger. I might state, there is only one reason for offering it at all.

The Court: There is no reason to show it to me. It is the record it has to get in.

Mr. Latham: It is the fact of the reference to 9-16-43 as of January 1, 1943. I think that is the only reason [127] that Mr. Mather is interested in that entry, and asked to have it introduced.

By Mr. Latham:

Q. Mrs. Harris, you have just heard me read the entry on page 40 of the general journal, of the Union Manufacturing Company. Do you know why that entry was not made until, apparently, September of 1943?

A. Well, I guess it was just an oversight because Mr. Egan probably thought that Mr. Harris would attend to it and Mr. Harris probably thought that Mr. Egan would tell Miss Goodenough, our bookkeeper, just how it should be done and it was neglected, as the time went along. In the course of conversation, we discovered that it hadn't been done. Mr. Egan very often would phone Miss Goodenough to tell her just how to do it. Mr. Harris assumed he had and he thought Mr. Harris had.

Q. Now, Mrs. Harris, the gifts that you have mentioned as made by yourself and your husband to your children, was not in fact made on or about September 16, 1943?

A. No.

Q. When was it made?

A. January.

Q. 1943?

A. Yes.

(Testimony of Anna Harris.)

Q. When was the understanding or oral agreement you referred to as to the new partnership reached between the four of [128] you?

A. Well, in December, just before January.

Q. To become effective the first of the following year?

A. Yes, become effective the first of the following year.

The Court: December what year?

The Witness: 1942. We decided on it to become effective 1943.

Mr. Latham: That is all.

Cross Examination

By Mr. Mather:

Q. Mrs. Harris, you were familiar with the conduct of the business from its inception, were you not? A. Yes.

The Court: We will take a short recess at that time.

(Short recess taken.)

The Court: Proceed.

By Mr. Mather:

Q. I believe I asked you if you were familiar with the conduct of the business over this period of years? A. Yes, I am.

Q. It is engaged in the manufacture of work clothes? A. That is right.

Q. Was there any change in the method in which the business was conducted, during the years that we are interested in? [129]

A. With respect to what—change of—

Q. The conduct of the business. Was it oper-

(Testimony of Anna Harris.)

ated the same in 1942, 1943, 1944 and 1945, as it always had been?

A. Yes, I guess so, excepting the change in partnership.

Q. Well, would that involve any change in the operation of the business or the conduct of the business?

A. We still manufacture the same things. I don't know just what you are referring to.

Q. Did it in the same way as you always had?

A. Yes.

Q. Neither of the children performed any service in 1942 and 1943, did they?

A. No, excepting—well, Albert worked in—in '42 did you say?

Q. '43 and '44.

A. '43 and '44. Well, Albert was in the Service, I think at that time. He couldn't very well. He would have—

Q. He entered North Carolina State Textile Engineering School in September, 1942 and then entered the Service April, 1943?

A. That is right.

Q. Now, no documents of any character were executed in connection with these gifts to the children other than the exhibits that have been offered here in evidence, is that [130] correct?

A. No documents, no. But we had oral agreements.

Q. No bill of sale or anything of that character?

A. No.

(Testimony of Anna Harris.)

Q. Did you have anything to do with separation of income tax returns? A. Yes.

Q. When the children were taken into the business, was the tax liability discussed?

A. I can't remember.

Q. There was no discussion, then, I understand?

A. No, I don't think so.

Mr. Mather: That is all.

Mr. Latham: That is all, Mrs. Harris.

The Court: I would like to ask a few questions, Mrs. Harris.

In 1942 your daughter was in school, I understand. What school was she attending?

The Witness: How old was she? I could tell better then.

The Court: Let me see—

Mr. Latham: Sixteen, I will say.

The Witness: She was probably attending either the Flintridge School for Girls, in Pasadena, or she was going to the University High School. I don't remember. She changed— [131.]

The Court: Did she go to college?

The Witness: She is at college now, yes.

The Court: Where is she attending college?

The Witness: The University of Southern California—no, it isn't—now, what is it?

Mr. Latham: University of California at Los Angeles.

The Court: When did she enter, do you remember, when she was a freshman?

The Witness: She was a freshman at Mills College in Oakland. She started at that college.

(Testimony of Anna Harris.)

The Court: When did she start at Mills?

The Witness: I am not good at remembering.

The Court: Immediately after graduating from high school?

The Witness: Yes, whenever that would be.

The Court: Was she sixteen or seventeen when she graduated?

The Witness: Probably seventeen. She must have been about seventeen when she started college.

Th Court: She would have started at Mills in 1943 or 1944, is that right?

The Witness: Probably.

The Court: Now, she is now attending the University of California?

The Witness: That is right. [132]

The Court: What year is she in?

The Witness: I think she is a junior.

The Court: What is she studying?

The Witness: General education.

The Court: General arts course?

The Witness: Well, I don't know exactly. She has changed so much.

The Court: I guess that is all.

Mr. Latham: You may step down.

(Witness excused.)

Mr. Latham: Mr. Harris, will you be sworn and take the stand?

Whereupon,

MORRIS HARRIS,

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Court: State your name, please.

The Witness: Morris Harris.

Direct Examination

By Mr. Latham:

Q. You are Morris Harris, one of the petitioners in this proceeding? A. Yes, sir.

Q. Where do you reside? [133]

A. 10398 Sunset Boulevard.

Q. Los Angeles? A. Los Angeles.

Q. The witness who preceded you is your wife, Mrs. Anna Harris? A. That is right.

Mr. Latham: If your Honor please, to expedite this situation, rather than merely ask the witness the same questions which I asked of the last witness, I would simply like to ask—

By Mr. Latham:

Q. You have heard the testimony of Mrs. Harris, who preceded you on the stand? A. Yes.

Q. Are the statements which she made correct insofar as you know? A. Yes.

Q. Have you anything to add in connection with this situation, to her testimony? A. No.

The Court: Do you want to ask the witness any questions?

Mr. Mather: No, your Honor.

Mr. Latham: That is all.

(Testimony of Morris Harris.)

The Court: I want to ask the witness a few questions. [134]

By the Court:

Q. You went into this business back in the early part of the 1900's, did you? A. 1909.

Q. 1909. How did you acquire your interest in the business; did you purchase it?

A. No, I opened the business; I was the originator of the business.

Q. Do you keep your earnings in the business, build up the capital? A. Yes, I am.

Q. Are you the manager of the business.

A. Yes, I am.

Q. In 1941, about what was the volume of your sales?

A. I couldn't remember offhand; probably around a couple of million dollars; I don't remember exactly but I figure it was—

Q. About how many people did you have; how many employees in 1942?

A. 1942, around 400.

Q. About 400? A. Yes.

Q. Where do you carry on this business; in a plant?

A. In a plant in Los Angeles, and right now we have another place of business in Texas. [135]

Q. In 1942, you had just the plant in Los Angeles?

(Testimony of Morris Harris.)

A. In 1942 we had the place in El Paso, Texas too, a small place.

Q. How many people did you employ in El Paso?

A. Well, in El Paso, off and on, around 300.

Q. In 1942?

A. No, not in 1942. In 1942 probably around 100.

Q. Where is your plant located, in Los Angeles? A. 110 West 11th.

Q. Is that down town? A. Down town.

Q. Do you own the plant?

A. I own the building of the plant, yes.

Q. About how much did you consider your plant was worth, your land and building, in 1942?

A. Well, in 1942 real estate was not very high. Probably around \$300,000, \$350,000, building alone without the equipment.

Q. About \$300,000, \$350,000. What kind of equipment do you have in your plant?

A. All kinds of machinery, sewing machines and everything.

Q. What kind of clothes do you make?

A. Work clothes and sport clothes.

Q. Men's or women's? A. Men's. [136]

Q. How many managers or foremen do you have to have?

A. Well, we have several floorladies upstairs, and then one superintendent.

Q. That was true in 1942?

(Testimony of Morris Harris.)

A. This was true for the last fifteen years.

Q. Do you employ salesmen? A. Yes.

Q. Do you have to do that to sell your goods?

A. Yes.

Q. Where do you sell your goods?

A. Now, all over the United States.

Q. In 1942 did you?

A. In 1942, up to the Rocky Mountains only.

Q. Just on the Pacific Coast and Rocky Mountain region? A. That is right.

Q. About how many salesmen did you employ in 1942?

A. We had, off and on, between 10 and 12.

Q. How did you employ them; on a salary or commission?

A. Commission; all on commission.

Q. About how many customers did you have; did you have a lot of customers or did you just have some main outlets?

A. A long time ago we used to work just in department stores. Right now we sell most of our stuff in chain stores.

Q. But, in 1942 you were selling to chain stores too? A. Yes. [137]

Q. Did you draw a salary in 1942?

A. Yes.

Q. How much was your salary in 1942?

A. I couldn't remember offhand. It seems to me around \$200 a week if I can remember right.

Q. About \$200 a week? A. Yes.

(Testimony of Morris Harris.)

Q. Then what did you do, distribute; did you have a drawing account or distribute profits, at the end of the year to yourself?

A. I had a drawing account against my profits.

Q. Now, after these accounts were set up on the books in 1942, did you have your bookkeeper allocate certain—a certain percent of profits to your son and to your daughter? A. Yes.

Q. What happened to those allocations of profit; did they remain there?

A. They were left in the business.

Q. Children didn't have drawing accounts?

A. They could have drawn if they wanted to, but they didn't.

Q. They didn't draw anything out?

A. No.

Q. Now, when you made that arrangement, your son didn't put any machines or money or anything into the business? [138] A. No, except he—

Q. The answer is, he didn't put in any capital?

A. No capital.

Q. Did he put in any capital, yes or no?

A. He did not.

Q. He wasn't a foreman? A. No.

Q. He was not a salesman?

A. No, he was doing general work.

Q. He was about seventeen?

Mr. Latham: Nineteen.

The Court: But he was doing some work around the plant for three months in his vacation?

(Testimony of Morris Harris.)

The Witness: Yes.

The Court: That is all. I have no other questions of Mr. Harris.

The Witness: He went to a textile school at night.

Mr. Latham: I have just two matters, your Honor.

Mr. Latham:

Q. Mr. Harris, this salary that the Court spoke to you about, was charged against your drawing account? A. Drawing account, yes.

Q. Not in addition to your percentage of profits? A. No.

Q. Albert worked at the company's plant prior to 1942, [139] did he not? A. Yes.

Mr. Latham: I have nothing further.

The Court: Now, on that, he was in school, wasn't he?

The Witness: But whenever he had spare time he used to come over and help us.

Mr. Latham: We will stipulate, of course, that he was in school continuously, except for summer vacations.

The Witness: He was preparing himself to go into the business.

The Court: I guess that is all, Mr. Harris.

(Witness excused.)

Whereupon,

ALBERT P. HARRIS

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name for the record.

The Witness: Albert P. Harris.

Direct Examination

By Mr. Latham:

Q. You are Albert P. Harris?

A. That is right.

Q. You are the son of Mr. Morris Harris and Mrs. Anna [140] Harris who preceded you on the stand?

A. Yes.

Q. How old are you? A. Twenty-four.

Q. And where do you live?

A. 10398 Sunset Boulevard.

The Court: That is your parents' address?

The Witness: Yes.

By Mr. Latham:

Q. You are about to be married?

A. Correct.

Q. What is your occupation?

A. Well, I don't have any title down there. I just do general work, trying to help my father. I sign the checks, I have done some buying made a couple of trips back and forth between the two

(Testimony of Albert P. Harris.)

factories. I wait on customers there—well, I just sort of—

Q. You are connected with the Union Manufacturing Company, are you not? A. Yes, I am.

Q. When did you finish high school?

A. Finished high school in the summer, June 1941.

Q. You were then eighteen years old?

A. Yes.

The Court: What high school did you go to?

The Witness: Los Angeles High.

By Mr. Latham:

Q. In Los Angeles? A. Yes.

Q. Then what did you do?

A. I went back east in September to the University of Virginia, and I went to college there for the next year.

Q. For the year that ended in June of 1942?

A. Yes.

Q. What was the nature of the course that you took there?

A. It was just a general first year, freshman course; nothing specific.

Q. You returned to Los Angeles in the — in June or whenever school was out, in 1942?

A. Yes.

Q. Prior to that time, prior to the summer of 1942, had you worked in the offices or plant of the Union Manufacturing Company?

A. I had been down there off and on helping

(Testimony of Albert P. Harris.)

out. I came down with dad sometimes, with dad on week ends and came down after school at times and helped out.

Q. That was after school during vacation periods?

A. Even earlier than that. I used to come down with my father and work around there, and then after school at times. [142]

Q. Prior to the summer of 1942, had you ever considered with your parents whether or not you would enter that business?

A. Well, it had always been my ambition to go in some day with my father, when I was old enough. That was my intention, when I finished high school, but at that time they wanted me to go to college and I obeyed them and went to college.

Q. You say you wanted to go directly into the business from high school? A. Yes.

Q. Why didn't you?

A. They told me at that time that I would be more help in the business if I have a college education.

Q. When you came back to Los Angeles, we will say, June of 1942, what did you do?

A. Well, at that time I was pretty fed up with college. I had spent a year there like they wanted me to, and I didn't particularly care for it. I didn't want to go—I wanted to go into the business, and I felt like that past year was just wasted. I spent

(Testimony of Albert P. Harris.)

a full four years there and I still would have had to start from scratch, so when I came back then, I told my parents at that time that I didn't care much for it, and that I wanted to go into the business.

They saw that my mind was firmly made up, so at that [143] time there was some talk about my going into the business, but they thought I should have a little more education and it would be best if I had definitely made up my mind at that time to get a little more education in the textile field. So, during that summer I went to U.S.C. and took a course there for the three months I was home, at night, in textiles.

During the day I was down at the factory, helping out, doing various things down there.

Q. You worked throughout the summer at the plant and went to a special textile school at night?

A. Yes, I did.

Q. When the fall of 1942 came, what did you do?

A. The fall of 1942, I went to Raleigh to the textile school, in North Carolina, and I was there until—well, in December, I believe it was, I then enlisted in the Army, because I figured I would rather go in that way than to be drafted, when I saw I would have to go anyway.

I returned home at Christmas and at that time we talked about the partnership, and it was definitely established at that time that the first of

(Testimony of Albert P. Harris.)

next year, that my sister and I would become partners.

I went back there and I was at school until the first part of April.

Q. 1943?

A. Yes, '43, until I was called for active duty.

Q. Called into the Service? A. Yes.

Q. How long were you in the Service?

A. I was in the Service from April, 1943, until January, 1946, when I was discharged. About 33 months.

Q. When you were discharged, what did you do?

A. I immediately went back into the business there. I went in the next week.

Q. Decided you didn't need any more college?

A. Well, I figured what college I could get, I would get at night, and I went to U.S.C. again. I don't know how many more units I took. I also went to U.C.L.A. and took up a bookkeeping course there at night and also went to the business school, Southwestern University Business College and I took some more courses there. I felt they would definitely help me in the business.

Q. Since your discharge from the Army in January of 1946, you devoted all your daylight hours to this business?

A. Yes, I did. All my schooling was at night.

Q. State the nature of your activities since your return?

(Testimony of Albert P. Harris.)

A. You mean when I first came back?

Q. Yes. What in general have you done in the last two years?

A. When I first returned, I wanted to get a thorough [145] knowledge of the business, and I spent most of my time in the factory, for the first couple of months, seeing how our business operated and how the garments were made. Then, as I gradually knew what was going on there, I came down into the office and I waited on customers and helped with the filling of the orders, shipping and so forth like that.

Then, at that time, I also—around that time, I went back east on a buying trip with my uncle. My dad generally went, but I went this time and helped my uncle back there. I had also been to El Paso, our other plant, to handle some matters there.

It was the first of 1947, if I am not mistaken, that my uncle passed away, who was in the business with us, and at that time I fell heir to a lot of work down there. From that time on I was in the office handling most of the sales, customers and buying and handling the checks, signing of the checks and, well—generally, just about everything, so that I could make it as easy as possible on my dad.

Also, I went to El Paso again on some matters over there.

Q. Now, going back to 1942, before you re-

(Testimony of Albert P. Harris.)

turned to North Carolina to school, it had been definitely understood and agreed that as soon as your schooling was completed, or whenever you got out of the Service—

Mr. Mather: Just a moment. Let the witness testify, [146] if you don't mind.

Mr. Latham: I will withdraw that.

By Mr. Latham:

Q. What was your understanding at the time you returned to North Carolina, in the fall of 1942?

A. I definitely understood that, at the end of that year, I would become a partner, along with my sister, Betty?

Q. When was that to be?

A. Well, we had talked about it in June when I came back, and it was my understanding that, at the end of the year, both of us would go in there as partners and when I came home in December of 1942, we definitely, I mean, it was definitely understood then.

Q. Discussed and agreed? A. Yes.

Mr. Latham: That is all.

Cross Examination

By Mr. Mather:

Q. In December when these conversations about a partnership were had, who was present?

A. Mother, daddy, Betty and myself.

Q. Just what was said?

A. Well, we talked about it and my father wanted me to come in for some time. I was anxious

(Testimony of Albert P. Harris.)

to go in then, but they wanted me to go back, so they said they would give me this, [147] but I had to go back though for at least another year. I don't—I mean—exactly what was said at that time, is rather vague now, but it was understood I would go back until at least, I had a knowledge so I could go about the business.

Q. You were still going back to school in December, weren't you? A. Yes, I was.

Q. You did go back to school in North Carolina? A. Yes.

Q. Now, during 1942, did you know anything about the operation of the business?

A. As much as a boy of my age would know about it.

Q. Well, was that any or a lot?

A. As much as anybody would know; probably a little more, because I had an interest in it and I went down there on my own time. I just liked to be down there and see what was going on. It had been my intentions for some time, because my father wanted to sell the business back in '36 or '37, and I told him then that I would like to go in.

Q. You testified that when you came back in 1946, you immediately went into the business and you went down there to learn how garments were manufactured and how the business was operated, didn't you?

A. I wanted a thorough knowledge at that time of everything. I just didn't want to step in down

(Testimony of Albert P. Harris.)

at the office [148] and tell people what to do, when you don't know absolutely everything about it yourself.

Q. Your uncle understood the business and knew how it was operated, did he not?

A. I did have two down there.

Q. But the one you testified with respect to that is no longer with them.

A. He understood a certain phase of the business, he didn't understand it all.

Q. Do you understand all the phases of the business yet?

A. I think as well as you could learn in the couple of years I have been down there.

Q. Do you or don't you understand it all now?

A. Yes.

Q. In helping out, what did your duties consist of, in '42?

A. What do you mean?

Q. Running errands?

A. No. A little more than that. I came down there and filled orders, helped pack merchandise, put away the stock. Generally, during the summer, that is our busy time, and we have an abundance of work down there, and I used to come in during that period and help them fill all the orders and help pack. [149]

Q. About what salary would they pay someone to perform the duties you performed in helping out in 1942?

(Testimony of Albert P. Harris.)

A. I wouldn't know at that time. I know what they pay them now.

Mr. Mather: That is all.

Mr. Latham: We have nothing further.

Mr. Mather: Respondent rests.

Mr. Latham: Petitioner rests.

The Court: How about the bookkeeper? I would like to have the woman that kept the books for the company take the stand. I just have a few questions.

Whereupon,

JUNE GOODENOUGH,

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Court: State your name, please.

The Witness: June Goodenough.

Direct Examination

By the Court:

Q. Now, Miss Goodenough, I want to ask you to give us the facts about the capital set-up of Union Manufacturing Company, prior to January 1, 1942. This business has been in existence since around 1907.

A. 1909 is the date, I believe. [150]

Q. The assets of the business, as I understand it, consisted of, in 1942, two plants, machinery, in-

(Testimony of June Goodenough.)

vested capital, accumulated surplus, and so forth?

A. That is right.

Q. Now, some of the books and accounts of the Union Manufacturing Company have been brought into the Court this morning. Is there anything here in the nature of a balance sheet, as of December 31, 1941, that would show the assets and liabilities of that business?

A. Well, I have not brought any in; not to my knowledge.

The Court: Have you anything of that kind, Mr. Mather?

Mr. Mather: There is a balance sheet, if your Honor please, in the partnership return, one of the partnership returns, and I have balance sheets here for 1942 and 1943.

The Court: Well, it would be helpful to have a balance sheet in evidence, so that we would understand what capital set-up of this business is. Ordinarily, there isn't a place on a partnership return for a balance sheet. It is attached to the partnership return schedule of certain depreciable property, but I think that is all.

Mr. Latham: Here is one which Mr. Mather has for December, 1942 and December, 1943. [151]

By the Court:

Q. Then, I will ask you to look at the balance sheet for December 31, 1942. Now, if you didn't prepare the balance sheet or don't know anything about it, you will have to say so.

(Testimony of June Goodenough.)

A. I did prepare it.

Q. You did prepare that balance sheet. You prepared that from the books of the company?

A. That is right.

Q. That is a true statement of the assets and liabilities? A. Yes, it is.

Q. I show you a balance sheet dated December 31, 1943. Did you prepare that?

A. Yes, I did.

The Court: Now, I would like to have these introduced in evidence by whomever wishes to present them.

Mr. Latham: I will offer these as Petitioners' exhibits, whatever they are, 15 or 16.

Mr. Mather: I thing it is 16 and 17.

The Court: Balance sheet for December 31, 1942, will be received in evidence as Exhibit 16.

(The document above-referred to was received in evidence and marked Petitioner's Exhibit No. 16.)

[Petitioner's Exhibit No. 16 is set out in full, page 159, of this printed Record.]

The Court: Balance sheet as of December 31, 1943, [152] is received in evidence as Exhibit 17.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 17.)

[Petitioners' Exhibit No. 17 is set out in full, page 160, of this printed Record.]

(Testimony of June Goodenough.)

By the Court:

Q. Now, if you will refer to Exhibit 16, you will find there the capital accounts. Now, what capital account do we have on that balance sheet?

A. For Mr. M. Harris and one for Mrs. A. Harris.

Q. M. Harris and what is the amount of his capital? A. As of the end of the year?

Q. End of 1942. A. \$471,351.04.

Q. Now, Mrs. Anna Harris is shown as having what capital? A. \$465,558.79.

Q. That is the amount after the addition to the previous balance of capital of one-half of 1942 profits, for each, less income taxes and less the amount withdrawn during the year?

Now, we have in evidence capital account of Mr. Morris Harris and Mrs. Anna Harris, Exhibits 12 and 13. Now, will you look at Exhibit 12. You find the balance for his capital account as of December 31, 1941. Would that be \$359,709.94?

A. Yes, because at that time we had two accounts; one [153] for capital, accumulated profit, and we combined them at the end of January, that year.

Q. You did. But, would you help me find that here?

A. That is this figure, \$359—these two added.

Q. You transferred as of January 31, 1942, one-half of accumulated profits to the capital account.

(Testimony of June Goodenough.)

That would be like one-half of surplus, wouldn't it, or accumulated profits?

A. It would mean half, but probably wouldn't be the identical amounts, because the drawings were transferred to that account during the year.

Q. The transfer, \$294,705.94—that gave a total of \$359,705.94.

A. Yes.

Q. Was the same transfer made in the case of Mrs. Anna Harris?

A. Yes.

Q. Now, we get to Anna Harris' account and you have an entry here, January 31, 1942. This is the credit side, is it not?

A. Yes.

Q. On the credit side of the account, transfer some accumulated profits, account journal, 117, \$259,699.14, which made a total of \$334,669.14. That is the balance which is shown on the balance sheet for December 31, 1942 as the total [154] of her capital account.

Now, when these accounts were set up on the books for each one of the children, each was to receive a one-sixteenth interest?

A. That is right.

Q. Now, what did you do to effect that in setting up the capital account for Albert? He received his interest, according to the Petitioners' theory from his mother, so, there would be a reduction, wouldn't there, in her capital account?

A. Yes.

Q. Now, where do you have the reduction in

(Testimony of June Goodenough.)

her capital account? His account is opened, isn't it?

A. As a matter of fact, the two names were switched here. That would be Albert and the other Betty, but there is the same amount involved.

Q. Now, wait a minute, according to the books, it was Morris Harris' capital account which was charged with some amount for a new capital account for Albert, is that right?

A. That is right.

Q. And his account was charged on September 16, 1943, with \$34,083.70; is that right?

A. That is right.

Q. Then, was the capital account for Albert opened with that amount? [155]

A. That is right.

Q. Where do we find that?

A. The top figure.

Q. We find that account opened then, as of January 1, 1943, although the transfer was made on September 16, 1943? A. That is right.

Q. Then, the capital account of Anna Harris, Mrs. Anna Harris, was charged on September 16, 1943, with \$34,083.70 and as of January 1, 1943, a capital account was opened in the name of Betty by an entry of \$34,083.70, is that right?

A. That is right.

Q. Now, then, looking at the account for Albert and Betty, what do we have here? As of December 31, 1943, we have a credit of \$21,870.95 in his

(Testimony of June Goodenough.)

account, and a credit in Betty's account of the same amount, and that is supposed to be what?

A. One-sixteenth share of the profits for the year.

Q. 1943? A. Yes.

Q. Now, the debit in each account for 1943 is \$9,879.79. What was that for?

A. That is to pay the estimated income tax for 1943.

Q. Federal and state or federal?

A. Federal.

Q. Just federal? A. Federal. [156]

Q. Now, the debit entries were to represent withdrawals, wouldn't they?

A. Yes, your Honor.

Q. The credit entries represent increases in the account? A. Yes.

Q. So, with that explanation we can understand these exhibits, is that right? A. Yes.

The Court: Do you want to ask the witness any questions?

Mr. Mather: There is one question I would like to ask.

Cross Examination

By Mr. Mather:

Q. You spoke of two businesses. They didn't acquire the El Paso business until 1943, did they?

A. 1940. It is the same business, however.

Q. Was it a new building they bought down in El Paso in 1943?

(Testimony of June Goodenough.)

A. I believe it was. The building was acquired at that time, at the present location.

Mr. Mather: I have nothing further.

The Court: That concludes the hearing in this proceeding, and the dates will be read now by the clerk for [157] the briefs, allowing 15 days extra time for reply briefs.

The Clerk: March 16 for the original briefs and reply briefs on April 16.

(Whereupon, at 4:30 o'clock p.m., Thursday, January 29, 1948, the hearing in the above-entitled matter was closed.)

[Endorsed]: T.C.U.S. Filed Feb. 20, 1948. [158]

PETITIONERS' EXHIBIT No. 1

Form 540

State of California—Income Tax Division

INDIVIDUAL INCOME TAX RETURN—RESIDENT

For Gross Incomes of More Than \$5,000 From Salaries, Wages, Dividends, Interest, Annuities, and for Incomes From Other Sources Regardless of Amounts (See Instruction B).

For Calendar Year 1942

of fiscal year begun....., 1942, and ended....., 1943

MORRIS HARRIS

10398 Sunset Boulevard, Los Angeles, California

1. Are you a resident of the State of California? Yes.
2. Were you married and living with husband or wife during taxable year? Yes.
3. Are all items of income or deductions of both husband and wife included in this return? No.
4. State (a) Name of husband or wife if a separate return was made: Anna Harris.

* * * *

6. How many dependent persons (other than husband or wife) received their chief support from you during your taxable year: (a) Under eighteen years of age: Three.
- * * * *
8. Check whether this return was prepared on the cash [x] or accrual [] basis.
9. State your principal occupation or profession: Partner—Union Mfg. Co.
10. Did you file a state return for any prior year? Yes. If so, what was the latest year? 1941.
11. Did you file a return with the Federal Government for 1942, or fiscal year stated herein? Answer "yes" or "no": Yes.
12. If the answer to No. 11 is "yes," state amount of net income (or loss) reported on the Federal return. Net income (or loss): \$228,931.78.
13. Has the Federal Government assessed or proposed to assess any additional income tax for 1940: No. 1941: No.

INCOME

* * * *

- | | |
|---|--------------|
| 2. Dividends | \$ 504.37 |
| 3. Interest on (a) bank deposits, notes, etc., \$.....; | |
| (b) corporation bonds \$....., | 17.52 |
| * * * * | |
| 5. Rents and royalties (from Schedule B)..... | 17,495.06 |
| * * * * | |
| 8. Income (or loss) from partnerships, syndicates, pools, etc. (furnish names and addresses) Union Manufacturing Co., 110 West 11th St. L. A..... | 227,235.34 |
| 9. Income from fiduciaries (furnish names and addresses) Union Ranch, 110 West 11th St., L.A. | 729.67 |
| * * * * | |
| 11. Total Income in Items 1 to 10..... | \$245,981.96 |

DEDUCTIONS

- | | |
|---|--------------|
| 12. Contributions (explain in Schedule E) | |
| See schedule | \$ 1,581.37 |
| * * * * | |
| 14. Taxes (explain in Schedule E) See schedule..... | 2,860.23 |
| * * * * | |
| 18. Total Deductions in Items 12 to 17..... | \$ 4,441.60 |
| 19. Net Income (Item 11 minus Item 18)..... | \$241,540.36 |

COMPUTATION OF TAX (See Instruction 24)

20. Net Income (Item 19 above).....	\$241,540.36	
21. Less: Personal exemption (See Instructions 21-22)	\$2,500.00	
22. Credit for dependents.....	1,200.00	3,700.00
23. Balance subject to Tax.....		\$237,840.36
24. Tax (See Instruction 24).....		\$ 26,747.65
* * * *		
26. Balance of Tax.....		\$ 26,747.65

AFFIDAVIT (See Instruction F)

I swear (or affirm) that this return (including its accompanying schedules and statements, if any) has been examined by me, and to the best of my knowledge and belief is a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to The Personal Income Tax Act.

This declaration made under penalty of perjury

(If return is made by agent, the reason therefore must be stated on this line.)

.....
(Signature) (See Instruction F)

.....
(Signature)

(If this is a joint return (not made by agent), it must be signed by both husband and wife, but it need be sworn to before a proper officer only by the spouse preparing the return. If neither or both prepare the return, it must be sworn to by both spouses.)

Subscribed and sworn to by.....before
me this.....day of March, 1943.

.....
(Signature and title of officer administering oath.)

SCHEDULE A—Interest on State, Municipal, and Other Bonds or Obligations (See Instruction 4)

1. Bonds or Obligations	2. Amount Owned	3. Interest Received or Accrued
* * * *		
(b) Obligations of the United States, or of the District of Columbia.....	\$38,000.00	\$97.50
* * * *		

MORRIS HARRIS—1942 CONTRIBUTIONS

Line 12

One-half contributions \$1209.86

Union Manufacturing Company—a partnership. University Religion Conference \$10.00; Friday Morning Club Fund \$2.50; Los Angeles Science League \$2.20; U. S. O. \$43.00; Council Thrift Shop \$5.75; Open House Fund \$20.00; Temple Sisterhood \$3.50; Westwood Auxiliary Defense \$10.00; Haddassah Fund \$9.90; Los Angeles Philamarnic Fund \$5.00; Hollywood Guild \$10.00; Home for Aged \$3.00; Women's Emergency Corps, \$10.00; Russian Relief \$16.50; Wilshire Boulevard Temple \$100.00; Vista Del Mar Fund \$8.50; Council of Jewish Women \$28.91; Julia Ann Nursery \$5.00; Red Cross \$15.00; Helping Hand \$59.25; Community Center \$3.50—Total \$1581.37

Line 14—Federal

City & County taxes \$2651.37; Auto License taxes \$48.80; Auto Stamp taxes \$27.21; Amusement taxes \$81.12; Phone taxes \$30.53; U. S. Luxury taxes \$21.20; Gasoline taxes, \$45.75; Sales taxes \$155.49; Calif. Income taxes \$12,407.34—Total \$15,468.81.

Line 14—State of Calif.

City & County taxes \$2651.37; Auto License taxes \$48.80; Auto stamp taxes \$27.21; Amusement taxes \$81.12; Phone taxes \$30.53; U. S. Luxury taxes \$21.20—Total \$2860.23.

Morris Harris, Los Angeles, Calif.—1942

	Rents	Deprec.	Rep.	Other Exp.	Profit & Loss
Brick	\$29,880.00	\$4,383.14		\$7,828.61	\$17,668.25
Stucco	2,100.00	1,100.00	\$44.91	1,128.28	173.19*
			Gain.....		\$17,495.06

* Loss

Line 1—Insurance \$772.53; Interest \$3937.50; Taxes \$3118.58—Total \$7828.61.

Line 2—Gardner \$246.59, fertilizer \$24.72, cleaning \$179.00, insurance \$25.00, taxes \$594.93, association dues \$12.00, lighting \$46.04—Total \$1128.28.

Schedule of Depreciation

	Acq.	Cost	Deprec. Allowed	Rem. Cost	Life	1942
Line 1—						
brick	1923	\$219,387.19	\$74,529.34	\$144,857.85	2%	\$4,383.14
Line 2—						
stucco		22,000.00	1,600.00	20,400.00	5%	1,100.00

[Endorsed]: T.C.U.S. Admitted in evidence Jan. 29, 1948.

 PETITIONERS' EXHIBIT No. 2

Form 540

State of California—Income Tax Division

INDIVIDUAL INCOME TAX RETURN—RESIDENT

For Gross Incomes of More Than \$5,000 From Salaries, Wages, Dividends, Interest, Annuities, and for Incomes From Other Sources Regardless of Amounts (See Instruction B)

For Calendar Year 1942

or fiscal year begun....., 1942, and ended....., 1943

ANNA HARRIS

10398 Sunset Blvd., Los Angeles, Calif.

1. Are you a resident of the State of California? Yes.
2. Were you married and living with husband or wife during your taxable year? Yes.
3. Are all items of income or deductions of both husband and wife included in this return? No.
4. State (a) Name of husband or wife if a separate return was made: Morris Harris.

* * * *

8. Check whether this return was prepared on the cash [x] or accrual [] basis.
9. State your principal occupation or profession: Partner Union Mfg. Co.
10. Did you file a state return for any prior year? Yes. If so, what was the latest year? 1941.

11. Did you file a return with the Federal Government for 1942, or fiscal year stated herein? Answer "Yes" or "No": Yes.
12. If the answer to No. 11 is "Yes," state amount of net income (or loss) reported on the Federal return. Net income (or loss): \$215,785.09.
13. Has the Federal Government assessed or proposed to assess any additional income tax for 1940: No. 1941: No.

INCOME

* * * *	
2. Dividends	\$ 1,664.38
3. Interest on (a) bank deposits, notes, etc., \$.....;	
(b) corporation bonds, \$.....,	125.71
* * * *	
5. Rents and royalties (from Schedule B).....	*628.56
* * * *	
9. Income from fiduciaries (furnish names and addresses) Union Manufacturing Co., 110 West 11th St., L. A.....	227,235.34
* * * *	
11. Total Income in Items 1 to 10.....	\$228,396.87
* Loss.	

DEDUCTIONS

12. Contributions (explain in Schedule E).....	\$ 1,209.86
* * * *	
18. Total Deductions in Items 12 to 17.....	\$ 1,209.86
19. Net Income (Item 11 minus Item 18).....	\$227,187.01

COMPUTATION OF TAX (See Instruction 24)

20. Net Income (Item 19 above).....	\$227,187.01
21. Less: Personal exemption (See Instructions 21-22)—Taken by husband	
* * * *	
23. Balance subject to Tax.....	\$227,187.01
24. Tax (See Instruction 24)	\$ 25,256.18
* * * *	
26. Balance of Tax.....	\$ 25,256.18

AFFIDAVIT (See Instruction F)

I swear (or affirm) that this return (including its accompanying schedules and statements, if any) has been examined by me, and to the best of my knowledge and belief is a true, correct, and

complete return, made in good faith, for the taxable year stated, pursuant to The Personal Income Tax Act.

This declaration made under penalty of perjury
(If return is made by agent, the reason therefor must be
stated on this line)

(Signature) (See Instruction F)

(Signature)

(If this is a joint return (not made by agent), it must be signed by both husband and wife, but it need be sworn to before a proper officer only by the spouse preparing the return. If neither or both prepare the return, it must be sworn to by both spouses.)

Subscribed and sworn to by.....before me
this.....day of194....

(Signature and title of officer administering oath.)

SCHEDULE A—Interest on State, Municipal, and other Bonds
or Obligations (See Instruction 4)

1. Bonds or Obligations	2. Amount Owned	3. Interest Received or Accrued
* * * *		
(b) Obligations of the United States, or of the District of Columbia.....	\$18,000.00	\$97.50
* * * *		

SCHEDULE B—Income from Rents and Royalties
(See Instruction 5)

1. Kind of Property	2. (Explain in Amount Sched. F)	3. Deprec. Amount	4. Repairs (Explain below)	5. Other Ex- penses (Item- ize below)
No rent received	none	\$300.00	\$87.93	\$240.63

Explanation of deductions claimed in Columns 4 and 5:
Gardner \$75.00; insurance \$12.50; taxes 150.58; lighting \$2.55—
Total \$240.63.

[Endorsed]: T.C.U.S. Admitted in evidence Jan.
29, 1948.

PETITIONERS' EXHIBIT No. 3

This Agreement, made in duplicate and entered into this 2nd day of January, 1924, by and between Morris Harris and Anna Harris, husband and wife:

Whereas, the above named parties are desirous of associating themselves together for the purpose of carrying on the business of manufacturing work clothing, and,

Whereas, the said Morris Harris is now the sole owner of the following described property and the business known as the Union Manufacturing Company:

Inventory of stock on hand.....	\$75,563.49
Accounts receivable	42,220.95
Insurance (prepaid)	246.28
Fixtures	358.40
Machinery	2,622.50
Stationery	188.79

Now, Therefore, the said Morris Harris for and in consideration of the sum of ten dollars and other good and valuable considerations, receipt whereof is hereby acknowledged does hereby grant, bargain, sell and convey unto the said Anna Harris a one-half interest in the above mentioned property.

It is mutually agreed by and between the respective parties hereto that all of the hereinbefore mentioned property shall immediately become partnership property to be used in the business known as the Union Manufacturing Company.

It is mutually agreed by and between the respective parties hereto that they shall and will, at all

times during the continuance of this agreement, bear, pay and discharge equally between them, all expense that may be required for the support [165] and management of said business; that all gains, profits and increase that shall come, grow or arise, from or by means of said business shall be divided between them share and share alike, and all loss that shall happen their joint business shall be borne and paid equally between them; that there shall be kept at all times during the continuance of this agreement just and true books of account.

This agreement shall remain in full force and effect for the term of ten years from the date hereof unless sooner abrogated and cancelled by mutual consent of the parties hereto.

In Witness Whereof, the parties hereto have set their hands.

MORRIS HARRIS

ANNA HARRIS

[Endorsed]: T.C.U.S. Admitted in evidence Jan. 29, 1948.

PETITIONERS' EXHIBIT No. 5

Form 1065

United States

PARTNERSHIP RETURN OF INCOME 1944

(To be Filed Also by Syndicates, Pools, Joint Ventures ,Etc.)

For Calendar Year 1944

or fiscal year beginning....., 1944, and ending....., 1945

[Stamped]: Serial No. 8719718. Received Mar. 15, 1945. Coll.

Int. Rev., Los Angeles, Cal. No. 4.

UNION MANUFACTURING COMPANY
110 West 11th Street, Los Angeles, California

Business or Profession: Mfgs. Men's work clothing

GROSS INCOME

1. Gross receipts from business or profession.....\$ 2,613,164.81

2. Less cost of goods sold:

(a) Inventory at beginning

of year\$ 586,878.36

(b) Merchandise bought

for sale 1,377,256.16

(c) Cost of labor, supplies, etc. 468,002.79

(d) Total of lines (a),

(b), and (c) 2,432,137.31

(e) Less inventory at end

of year 363,772.63 2,068,364.68

3. Gross profit (or loss) from business or pro-

fession (item 1 less item 2).....\$ 544,800.13

* * * *

8. Rents 1,251.94

* * * *

12. Other income (state nature of income) :

Discounts on Purchases 7,225.54

13. Total income in items 3 to 12.....\$ 553,277.61

DEDUCTIONS

14. Salaries and wages (do not include compensa-

tion for partners).....\$ 182,540.52

15. Rent 26,700.00

* * * *

17. Interest on indebtedness (explain in Sched. F) 5,479.32

18. Taxes (explain in Schedule C)..... 30,664.15

* * * *

21. Depreciation (explain in Schedule E)..... 8,056.30

* * * *

24. Other deductions authorized by law
(explain in Schedule F)..... 66,383.55

25. Total deductions in items 14 to 24.....\$ 319,823.84

26. Ordinary net income (item 13 less item 25).....\$ 233,453.77

* * * *

[Stamped on face of page 1]: Revenue Agent in Charge, Los
Angeles Division. Received Sep 18, 1945. Field.

* * * *

SCHEDULE C.—TAXES. (See Instruction 18)

Nature	Amount
City and county taxes.....	\$ 9,079.23
License	322.00
El Paso, Texas.....	4,295.64
Social Security	16,967.28
Total (enter as item 18, page 1).....	\$ 30,664.15

* * * *

SCHEDULE E.—DEPRECIATION. (See Instruction 21)

See Schedule	9. Depreciation al- lowable this year
Total (enter as item 21, page 1).....	\$8,056.30

SCHEDULE F.—EXPLANATION OF DEDUCTIONS
CLAIMED IN ITEMS 17 AND 24

1. Item No.	2. Explanation	3. Amount
	See Schedule	
		\$66,383.55

* * * *

SCHEDULE H.—CONTRIBUTIONS OR GIFTS PAID
(See Instruction for Schedule I)

Name and address of organization	Amount
See Schedule	
Total (enter in column 9, Schedule I).....	\$7,515.37

SCHEDULE I.—PARTNERS' SHARES OF INCOME AND CREDITS (See Instruction for Schedule I)

1. Name and address of each partner	2. Ordinary net income less interest on Government obligations, etc.
(a) Morris Harris, 10398 Sunset Blvd., Los Angeles	\$102,136.03
(b) Anna Harris, 10398 Sunset Blvd., Los Angeles	102,136.02
(c) Albert Harris, 10398 Sunset Blvd., Los Angeles	14,590.86
(d) Betty Harris, 10398 Sunset Blvd., Los Angeles	14,590.86
Totals	\$233,453.77

Continuation of Schedule I

9. Charitable Contributions (From Schedule H)
\$3,287.98
3,287.97
469.71
469.71
Total
\$7,515.37

QUESTIONS

1. Date of organization: 1909.
2. Nature of organization (partnership, syndicate, pool, joint venture, etc.): Partnership.
3. Was a return of income filed for preceding year? Yes. If so, to which collector's office was it sent? Los Angeles.
4. Check whether this return was prepared on cash [] or accrued [x] basis.
5. State whether inventories at the beginning and end of the taxable year were valued at (a) cost, or (b) cost or market whichever is lower: Cost or market whichever is lower.
6. Did the organization at any time during the taxable year own directly or indirectly any stock of a foreign corporation or of a personal holding company, as defined in section 501 of the Internal Revenue Code): (Answer "Yes" or "No"): No.
7. Was return of information on Forms 1096 and 1099, Form W-2 or Form W-2a, filed for the calendar year 1944: Yes. (See Instruction H.)

AFFIDAVIT (See Instruction D)

I swear (or affirm) that this return (including any accompanying schedules and statements) has been examined by me, and to the best of my knowledge and belief is a true, correct, and complete return.

/s/ ANNA HARRIS

Date 3/9/45

(Partner or member)

110 West 11th Street, Los Angeles, Calif.

/s/ D. WEBSTER EGAN

Date 3/9/45

(Signature of person (other than partner or member) preparing return)

Subscribed and sworn to before me this 12th day of March, 1945.

/s/ FRANK LOBER,

(Signature of officer administering oath)

Union Manufacturing Company—1944

SCHEDULE OF DEPRECIATION

	Acq.	Cost	Dep. Allowed	Rem. Cost	Life	Dep. 1944
Auto	1940	1965.45	1597.05	368.40	25%	368.40
Furniture	1940	319.83	124.19	195.64	10%	31.98
“	1941	168.95	33.80	135.15	10%	16.90
“	1942	332.15	66.42	265.73	10%	33.21
“	1943	145.50	2.03	143.47	10%	14.00
Machinery	1935	7713.26	6987.20	726.96	10%	726.06
“	1936	12799.72	10429.04	2370.68	10%	1185.44
“	1937	1803.78	1050.85	752.93	10%	180.38
“	1938	3434.69	1916.87	1517.82	10%	343.47
“	1939	4736.66	2174.76	2561.90	10%	473.36
“	1940	7164.57	992.83	6171.74	10%	716.45
“	1941	12518.26	4640.61	7877.65	10%	1251.83
“	1942	13921.70	2754.37	11167.33	10%	1392.17
“	1943	1797.47	112.00	1685.47	10%	179.75
“	1944	7766.51	0.00	7766.51	10%	395.40
Buildings	1944	32500.00	0.00	32500.00	2%	650.00
“	1944	6500.00	0.00	6500.00	5%	97.50

 8056.30

Other deductions: Auto Expense 630.75; Discounts 8177.77;
 Dues and Assessments 1644.29; General Expense 38088.16;
 Insurance 6267.10; Telephones and Telegrams 1298.21;
 Travel Expense 4974.20; Utilities 5303.07. Total: 66,383.55.

Contributions: Palestine Society 10.00; Central Jewish Committee \$5.00; West Gate Lodge Fund 2.00; War Chest 1000.00; Red Cross 2000.00; Naval Aid 121.37; Orthopaedic Foundation 500.00; Boy Scouts 12.00; Home for Aged 20.00; Wilshire Blvd. Temple 1000.00; Evely Smith Fund 25.00; Boys Camp 10.00; American Council for Judaism 10.00; El Nido Camp 300.00; Jewish Welfare 2500.00; Total 7515.37.

[Endorsed]: T.C.U.S. Admitted in evidence Jan. 29, 1948.

PETITIONERS' EXHIBIT No. 6

Form 1065 United States
 PARTNERSHIP RETURN OF INCOME 1943
 (To be Filed Also by Syndicates, Pools, Joint Ventures, Etc.)

For Calendar Year 1943
 or fiscal year beginning....., 1943, and ending....., 1944

UNION MANUFACTURING COMPANY,
 110 West 11th Street, Los Angeles, 15, California

Serial No. 988045 [Stamp] Mar. 15, 1944

GROSS INCOME

1. Gross receipts from business or profession.....\$ 2,858,253.17
2. Less cost of goods sold:
 - (a) Inventory at beginning
 of year\$ 538,992.70
 - (b) Merchandise bought
 for sale 1,788,851.00
 - (c) Cost of labor, supplies, etc. 456,875.99
 - (d) Total of lines (a),
 (b), and (c)..... 2,784,719.69
 - (e) Less inventory at end
 of year 586,878.36 2,197,841.33
3. Gross profit (or loss) from business or
 profession (item 1 minus item 2)..... 660,411.84
- * * * *
11. Net gain (or loss) from sale or
 exchange of property other
 than capital assets (from
 Schedule B)\$ 352.56

144 *Anna Harris and Morris Harris vs.*

* * * *

13. Other income (state nature of
income) Discount on purchases 9,343.95

14. Total income in items 3 to 13 (enter non-
taxable incomes in Schedules A and G).....\$ 670,108.35

DEDUCTIONS

15. Salaries and wages (do not include
compensation for partners).....\$176,159.38

16. Rent 26,700.00

* * * *

18. Interest on indebtedness (explain
in Schedule F)..... 2,786.31

19. Taxes (explain in Schedule C)..... 32,807.89

* * * *

22. (a) Depreciation (explain in
Schedule E) 7,401.39

* * * *

24. Other deductions authorized by
law (explain in Schedule F)..... 43,340.80

25. Total deductions in items 15 to 24.....\$289,195.77

26. Ordinary net income (item 14 minus item 25).....\$380,912.58

* * * *

SCHEDULE B.—GAINS AND LOSSES FROM SALES OR
EXCHANGES OF PROPERTY OTHER THAN CAPITAL
ASSETS (See Instruction 11)

1. Kind of property	2. Date acquired	3. Gross sales price (contract price)	4. Cost or other basis
Sewing machine	1935	\$100.00	\$ 350.00
Sewing machine	1936	704.00	1271.00

Schedule B—(Continued)

6. Depreciation allowed (or allowable) since ac- quisition or March 1, 1913 (furnish details)	7. Gain or loss (col. 3 plus col. 6 minus the sum of cols 4 and 5)
\$280.00	30.00
889.56	322.56

Total net gain (or loss) (enter as item 11, p. 1) \$352.56

SCHEDULE C.—TAXES (See Instruction 19)

Nature	Amount
City & County	\$11,663.64
	21,144.25
	<hr/>
Total (enter as item 19, page 1).....	\$32,807.89

* * * *

SCHEDULE J.—PARTNERS' SHARES OF INCOME AND CREDITS (See Instruction 29)

1. Name and addresses of each partner	2. Ordinary net income less interest on Government ob- ligations, etc., subject to surtax only
(a) Morris Harris, 10398 Sunset Blvd., L. A.	\$166,649.25
(b) Anna Harris, 10398 Sunset Blvd., L. A.	166,649.25
(c) Albert Harris, 10398 Sunset Blvd., L. A.	23,807.04
(d) Betty Harris, 10398 Sunset Blvd., L. A.	23,807.04
	<hr/>
Total.....	\$380,912.58

Schedule J—(Continued)

5. Use letter corre- sponding to above to identify partner	10. Charitable contributions (from Schedule I)
(a)	\$ 5,590.15
(b)	5,590.15
(c)	798.60
(d)	798.60
	<hr/>
Total.....	\$12,777.50

QUESTIONS

1. Date of organization: 1909.
2. Nature of organization (partnership, syndicate, pool, joint venture, etc.): Partnership.
3. Was a return filed for preceding year: Yes. If so, to which collector's office was it sent): Los Angeles.
4. Check whether this return was prepared on the cash [] or accrual [x] basis.
5. State whether inventories at the beginning and end of the taxable year were valued at (a) cost, or (b) cost or market, whichever is lower: Cost or market whichever is lower.

6. Did the organization at any time during its taxable year have in its employ more than eight individuals? (Answer "Yes" or "No"): Yes. * * *
7. Did the organization at any time during the taxable year own directly or indirectly, any stock of a foreign corporation or a personal holding company as defined in section 501 of the Internal Revenue Code? (Answer "Yes" or "No"): No.
8. Was return of information on Forms 1096 and 1099, or Forms V-2 and W-2, filed for the calendar year 1943? (See Instruction H): Yes.

AFFIDAVIT (See Instruction D)

I/we swear (or affirm) that this return (including any accompanying schedules and statements) has been examined by me/us, and to the best of my/our knowledge and belief is a true, correct, and complete return, made in good faith, for the accounting period stated, pursuant to the Internal Revenue Code and the regulations issued under authority thereof.

/s/ ANNA HARRIS Date 3/10/44
(Partner or member)
10398 Sunset Blvd., Los Angeles, Calif.

/s/ D. WEBSTER EGAN Date 3/10/44
(Signature of person (other than partner or
member) preparing return)
403 W. 8th St., Los Angeles, Calif.

Subscribed and sworn to before me this 15th day of March,
1944.

/s/ HARRY DAVID KROLL,
Notary Public in and for the City and County of Los Angeles,
State of California.

Union Manufacturing Company—1943

	Acquired	Cost	Depreciation	Remaining		Estimated	
				Cost	Life	Remaining Life	Deprec. 1943
Automobile	1940	1965.45	1105.65	859.80	4 yr.	1 yr.	491.40
Furniture	1943	145.50	0.00	145.50	10 yr.	10 yr.	2.03
"	1942	332.15	33.21	298.94	10 yr.	9 yr.	33.21
"	1941	168.95	16.90	152.05	10 yr.	9 yr.	16.90
"	1940	319.83	92.21	227.62	10 yr.	7 yr.	31.98
"	Prior	191.38	177.10	14.28	10 yr.	1 yr.	14.28
Machinery—L.A.	1933	1258.73	1191.02	67.71	10 yr.		62.84
"	1934	2319.37	1971.49	347.88	10 yr.	1 yr.	231.94
"	1935	7499.57	5682.20	1817.37	10 yr.	2 yr.	749.95
"	1936	13142.53	8542.63	4218.46	10 yr.	3 yr.	1314.25
"	1937	1159.00	637.45	521.55	10 yr.	4 yr.	115.90
"	1938	3277.40	1474.83	1802.57	10 yr.	5 yr.	327.74
"	1939	1691.48	3141.31	483.28	10 yr.	6 yr.	483.28
"	1940	2549.27	737.90	1811.37	10 yr.	7 yr.	254.93
"	1941	1082.50	225.25	857.25	10 yr.	8 yr.	108.25
"	1942	1097.35	97.23	1000.12	10 yr.	9 yr.	109.74
"	1943	2070.31	0.00	2070.31	10 yr.	10 yr.	103.50
Machinery—E.P.	1935	616.81	493.37	123.44	10 yr.	2 yr.	61.68
"	1936	715.25	500.64	214.61	10 yr.	3 yr.	71.52
"	1937	425.00	255.00	170.00	10 yr.	4 yr.	42.50
"	1938	190.55	95.25	95.30	10 yr.	5 yr.	19.05
"	1941	14723.17	2834.70	11888.38	10 yr.	8 yr.	1472.32
"	1942	12737.03	1273.70	11463.33	10 yr.	9 yr.	1273.70
"	1943	105.05	0.00	105.05	10 yr.	10 yr.	8.50

CONTRIBUTIONS

American Red Cross \$1610.00, S. C. Symphony Assn. \$50.00, United Nations W.R. \$100.00, Los Angeles Community Chest, \$1200.00, L. A. Hadassah \$5.00, Central Jewish Com. \$5.00, U. S. O. \$1500.00, African M. E. Church \$5.00, Home for Aged-Jewish \$100.00, Children's Hospital \$500.00, T. B. Christmas seals \$2.00, Filipino Bolo Knife \$5.00, Tuskegee Institute \$1.00, E. P. Community Chest \$100.00, West Gate Lodge F & M \$10.00, K.R.O.D.-El Paso \$10.00, Police Pension Fund \$33.00, V.D.M. Orphans Home \$2000.00, Boy Scouts-El Paso \$12.00, Passover Relief Bur. \$5.00, L. A. Orthopaedic Fd. \$500., Shrine Fund-El Paso \$7.50, N. Strauss Palestine \$10.00, Jewish Blind \$2.00, United Jewish Welfare \$5000.00, Veterans Army News \$5.00—
Total \$12,777.50.

Auto expense	\$ 577.71
Discount on sales	12,642.07
Dues and assessments	1,477.77
General expense	15,429.12
Gas	792.45
Insurance	4,661.59
Power and Light	4,226.23
Telephones and Telegrams.....	1,229.49
Travel expense	2,091.42
Water	212.95

\$43,340.80

All salary increases have been made in accordance with the established custom of firm and in compliance with War Labor Board regulations.

Field.

[Endorsed]: T.C.U.S. Admitted in evidence Jan. 29, 1948. [179]

PETITIONERS' EXHIBIT No. 7

Form 709

United States

GIFT TAX RETURN

Calendar Year 19.....

Donor: Anna Harris Address: 10398 Sunset Blvd., L. A.
Citizenship: American Residence: Same

Have you (the donor) during the calendar year indicated above, without an adequate and full consideration in money or money's worth, made any transfer exceeding \$4,000 in value (or regardless of value if in trust or a future interest) as follows?

(Answer "Yes" or "No")

1. By the creation of a trust (No) or the making of additions to a trust previously created (No), in either case for the benefit of a person or persons other than yourself, and with respect to which you retain no power to revest the beneficial title to the property in yourself or to change the beneficiaries or their proportionate benefits; or by relinquishing every such power that was retained in a previously created trust (No).
2. By permitting a beneficiary, other than yourself, to receive the income from a trust created by you and with respect to which you retained the power to revest the beneficial title to the property in yourself or to change the beneficiaries or their proportionate benefits (No).
3. By the purchase of a life insurance policy (No) or the payment of a premium on a previously issued policy (No) the proceeds of which are in either case payable to a beneficiary other than your estate, and with respect to which you retained no power to revest the economic benefits in yourself or your estate or to change the beneficiaries or their proportionate benefits; or by relinquishing every such power that was retained in a previously issued policy (No).
4. By permitting another to withdraw funds from a joint bank account which was deposited by you (No).
5. By conveying title to another and yourself as joint tenants or to your wife or husband and yourself as tenants by the entirety (No).
6. By any other method, direct or indirect (Yes).

If the answer is "Yes" to any of the foregoing, such a transfer should be fully disclosed under Schedule A.

COMPUTATION OF AMOUNT OF NET GIFTS FOR YEAR

1. Total included amount of gifts for year
(item c, schedule A)\$30,000.00
2. Total deductions for charitable, public,
and similar gifts for year (item c,
schedule B) None
3. Specific exemption claimed (see sec-
tion 10 of instructions).....\$30,000.00
4. Total deductions (item 2 plus item 3).....\$30,000.00
5. Amount of net gifts for year (item 1 minus item 4) None

COMPUTATION OF TAX (see section 14 of instructions)

* * * *

8. Total tax payable for year (item 6 plus item 7)..... None

AFFIDAVIT OF PERSON PREPARING RETURN

I swear (or affirm) that I prepared this return for the person named herein and that this return, including the accompanying schedules and statements, if any, is a true, correct, and complete statement of all the information respecting the donor's gift tax liability of which I have any knowledge.

.....
(Signature of person preparing return)

.....
(Address of person preparing return)

Sworn to and subscribed before me this 27th day of Sept., 1943.

.....
(Signature and title of officer administering oath)

SCHEDULE A—Total Gifts During Year (see sections 5, 6, 7, 9, 11, and 15 of instructions)

Description of gift, and Donee's name and address	Date of gift	Value at date of gift
An undivided 1/16 Interest in and to the property and assets of Union Mfg. Co., L. A., Cal., a partnership. Albert P. Harris, 10398 Sunset Blvd., L.A.	1/2/43	\$33,000.00

- | | |
|--|--------------|
| (a) Total | \$ 33,000.00 |
| (b) Less total exclusions not exceeding \$4,000 for each
donee (except gifts in trust or of future interests) | 3,000.00 |
| (c) Total included amount of gifts for year..... | \$ 30,000.00 |

SCHEDULE B.—Deductions for Charitable, Public, and Similar Gifts During Year (see sections 8, 9, and 12 of instructions)
None

SCHEDULE C.—Returns, Amounts of Specific Exemption, and Net Gifts for Preceding Year (subsequent to June 6, 1932)
None

[Endorsed]: T.C.U.S. Admitted in evidence Jan. 29, 1948.

PETITIONERS' EXHIBIT No. 8

Treasury Department, Internal Revenue Service

Form 710

GIFT TAX

DONEE'S OR TRUSTEE'S INFORMATION
RETURN OF GIFTS

Calendar Year 19.....

Donor's name: ANNA HARRIS.

Donor's address: 10398 Sunset Blvd., L. A.

Donee's name: ALBERT P. HARRIS.

Donee's address: 10398 Sunset Blvd., L. A.

Description of property received	Date of gift	Approx. value at date of gift
An undivided one-sixteenth interest in and to the property and assets of the Union Mfg. Co., a partnership.	1/2/43	\$33,000.00

Pursuant to the Gift Tax Regulations of the Treasury Department, I hereby give notice of the herein-described property received from the above-named donor, and certify that I have carefully read the instructions on the reverse side of this form and that all the information given herein is correct, to the best of my knowledge and belief.

(Signature).....

(Designation).....

(Address if donee's executor or administrator)

Date....., 19.....

[Endorsed]: T.C.U.S. Admitted in evidence Jan. 29, 1948. [182]

PETITIONERS' EXHIBIT No. 9

[This exhibit is identical with Exhibit No. 7 set out at page 149 with the exception of donor's name which is Morris Harris for Exhibit No. 9.]

[Endorsed]: T.C.U.S. Admitted in evidence Jan. 29, 1948. [183]

PETITIONERS' EXHIBIT No. 10

[This exhibit is identical with Exhibit No. 8 set out at page 151 with the exception of donor's name which is Morriss Harris for Exhibit No. 10.]

[Endorsed]: T.C.U.S. Admitted in evidence Jan. 29, 1948. [185]

PETITIONERS' EXHIBIT No. 11

Mailed 10/2/45

Treasury Department

Internal Revenue Service

Twelfth Floor, 417 So. Hill St.

Los Angeles, Calif.

Office of Internal Revenue Agent in Charge, Los Angeles Division

September 25, 1945

Mr. D. Webster Egan,
403 West 8th Street,
Los Angeles 14, California.

Dear Mr. Egan:

There is enclosed waiver forms to be signed by

Mr. Morris Harris and Mrs. Anna Harris, each fixed in the amount of \$1,200.00, which is the deficiency tax which I am recommending in connection with the 1943 gift tax returns filed by each of them. A copy of each waiver is enclosed for your files, and an addressed return envelope which requires no postage. The deficiency tax is based upon a valuation of a 1/16th interest in the Union Manufacturing Co. at \$53,000.00, which valuation was arrived at after considering all relevant factors and elements of value, including a value for good will.

There is enclosed affidavit forms which both of the aforementioned donors need to properly execute before a notary public and submit to this office in order that the gift tax returns which they filed for 1943 be technically completed. Each return must be executed after the close of the calendar year 1943, and as filed the returns were sworn to before the close of 1943, consequently are not technically complete returns. These forms are in triplicate, but only duplicates (2) need be returned to this office.

Submission of the waivers will expedite the settlement of this case and reduce the accumulation of interest. An early receipt of the waivers and affidavits will be appreciated. Thanking you for your cooperation rendered, I remain

Very truly yours,

/s/ HUGO C. BURNS,

Internal Revenue Agent. [186]



THE TAX COURT OF THE U.S.
DIV. 13 DOCKET
ADMITTED IN EVIDENCE

JAN 29 1948

PETITIONERS
EXHIBIT 12

4-55060646

MADE AT
WILSON JONES CO.
U. S. S.

DATE 1947	ITEMS	PAY	DEBITS	DATE 1948	ITEMS	REB	CREDITS
Feb 28	Accrued Income Tax	Q21	86,235.30	Dec 26	Balance		75000 -
Dec 14	Cell 2.5 for 1940	CD	9,108.	Jan 31	Transf. Acc. Payable	9117	287,107.94
" 15	Trans Payable	"	5,000.	Dec 31	" 1947 Payable	Q1	3,547,019.6
" 31	Drawing Accd	Q1	9,130.38				5,549,511.6
" 31	Balance		1,805.58				
Jan 31	Accrued Income Tax	Q2	49,351.04	Jan 1	Balance		471,351.04
Jan 4	Cell State Tax 1940	CD	23,401.32	Jan 20	Income tax adj.	Q19	5,273,019.6
" 21	"	"	16 -	Dec 31	1947 Payable	Q2	153,094.59
Sept 16	Accrued Income Tax	Q20	23,403.12				6,571,147.24
Jan 31	Drawing Accd	Q21	24,053.70				
" 31	Balance		2,511.14				
Mar 15	Cell 1943 Income Tax	Q22	23,616.90	Jan 1	Balance		3,554,445.30
Apr. 14	1944 Cell. Tax 1944	CD	355,445.30	Dec 30	1946 Payable		9,086,553
" 14	State Income Tax 1944	"	2,089,744				4,633,983.5
June 13	2nd 1/2	"	9,192.06				
Sept 12	3rd 1/2	"	20,897.44				
Dec 30	Balance		2,897.44	Jan 1	Balance		349,356.79
Nov 12	Cell 1944 Fed. Tax	CD	2,897.44	May 11	Payable Trans. Acct.	Q1	8750.
" 12	Cell 1945 " 1st 1/2	"	9,731.05	Sept 30	5, Sept Fed. Acct	Q105	4,012,637.9
Apr. 12	1944 State Income Tax	"	15,090.	" 30	70 State Income Tax	"	15,597
June 11	Cell 1945-2nd 1/2	"	3,066,178	" 30	" Fed. " " "	"	5,661.73
July 10	Cell Tax Pl. 1945-47	Q17	3,066,178	Dec 31	1945 Payable	Q140	4,012,637.9
Sept. 6	Cell 1945-3rd 1/2	CD	4,012,637.9				1,212,223.10
Dec 31	Drawing Accd	Q189	15,090.				5,264,370.9
" 31	Cell. Fed.		16,537.5				
			4,504,434				
			5,36,987.09				

BUSINESS ADDRESS

THE TAX COURT OF THE U.S.
DIV. 13 DOCKET 12984
ADMITTED IN EVIDENCE
JAN 29 1948
PETITIONER'S EXHIBIT 13
RESPONDENT'S

MADE BY
WILSON JONES CO.
U. S. A.

DATE	ITEMS	DEB	CRED	DATE	ITEMS	DEB	CRED
Feb 28	Accrued Income Tax	9121		Dec 30	Balance	50216.48	75000
Dec 16	Inv. Bonds	CD		Jan 31	Sum. Acc. Profit Acc.	5000.47	25669.14
Dec 31	Drawing Acc.	98		Dec 31	1/2 1944 Profit	9944.35	35602.58
" 31	Balance					46555.89	56073.26
Feb 1	Accrued Income Tax	913		Jan 1	Balance	18633.71	46555.89
June 30	Adv. " "	939		Dec 31	1943 Profit	3934.36	15309.67
Sept 16	Belly Taxes	940				19126.10	61863.31
Dec 31	Drawing Acc.	956				23405.37	
" 31	Balance					16241.78	
Mar 15	Bal. 1943 Inv. Tax	968		Jan 1	Balance	37266.07	37806.70
Apr 14	1944 Inv. Tax	CD		Dec 30	1944 Profit	20424.97	99885.88
" 14	Accrued Inv. Tax	"				19755.03	42894.25
June 13	2nd 1/2	"				48733.45	
Sept 15	3rd 1/2	"				19755.03	
Dec 31	Drawing Acc.	"				19755.03	
" 30	Balance					88442.34	
Mar 15	Bal. 1944 Inv. Tax	CD		Jan 1	Balance	96789.60	372632.19
" 15	1944 Inv. Tax	"		Dec 31	Profit on Inv. Bonds	4451.11	372632.19
June 15	2nd 1/2	"		May 11	Inv. Profit Tax	9500.00	7271.69
Sept 15	3rd 1/2	"		Sept 30	1/2 1944 Profit	15812.05	15579.7
Dec 31	Drawing Acc.	"		" 30	State Inv. Tax	9500.00	50120.1
" 30	Balance			" 30	" "	2135.13	28500.00
Mar 15	Bal. 1944 Inv. Tax	CD		Dec 31	1945 Profit	2135.13	40779.68
" 15	1944 Inv. Tax	"				38778.70	42832.09
June 15	2nd 1/2	"				42832.09	53311.29
Sept 15	3rd 1/2	"				48700.00	
Dec 31	Drawing Acc.	9189					
" 31	Balance						



THE TAX COURT OF THE U.S.
DIV. 13 DOCKET/1984
ADMITTED IN EVIDENCE

JAN 29 1948

PETITIONER'S
EXHIBIT
RESPONDENT'S

14

DATE	ITEM	FILE	DEBITS	DATE	ITEM	FILE	CREDITS
Dec. 18 1943	1943 Ex Income Tax	CD	9879.79	Dec 1	1943 Prgs	Q 40	3408.70
" 31	Balance		46,074.86	Dec 21	Balance	Q 56	2,157.85
Apr. 14 1944	1944 Ex. Inc. Tax	CD	13551.70	Jan 8	1944 Prgs		46,074.86
" 14	Income Tax	"	38,124.21	Dec 30			13,883.65
June 18	2nd 1/4	"	1,354.71				59,888.51
Sept 5	State Suffix Tax	"	3,137.97				
Sept 18	Income Tax 2nd 1/4	"	4,274.27				
Dec 30	Balance		53,829.59				
Mar 12	Bel. 1944 Inc. Tax	CD	272.27	Jan 1	Balance		53,829.59
" 12	Ex. 1945 - 1st 1/4	"	625.25	May 11	Prgs on Ex. Inc. Tax	CP	3,324.00
Apr 12	1944 State Inc. Tax	"	142.42	July 10	Ex. 1945 - Cap. G. 117		1,379.00
June 11	Ex. 1945 - 2nd 1/4	"	103.96	Sept 20	" State Inc. Tax	Q 120	54,920.00
Sept 6	" " 2nd "	"	166.66	" 30	" " "	"	1875.00
Dec 31	Balance		2,625.69	Dec 31	1945 Prgs	Q 160	57,007.00
			742,108.08				7,891.07

625
103.96
142.42
166.66
2,625.69
7,891.07

TERMS

ADDRESS

NAME

FORM
N-2-B

THE TAX COURT OF THE U.S.
DOCKET NO. 13
DIV. ADMITTED IN EVIDENCE
JAN 29 1948
PETITIONER'S EXHIBIT
DEPENDENCY

DATE	ITEMS	PAY	DEBITS	DATE	ITEMS	PAY	CREDITS
1943				1943			
Nov 15	1943 Est. Income Tax	CD	9879 79	Nov 1	1/16 Loans	Dec 10	34083 70
" 31	Balance		16070 86	Dec 21	1943 Profits	Dec 10	21870 95
Apr 14	1944 Est. Tax Paid.	CD	13170 30	Jan 1	Balance		40748 6
" 14	Income Tax - State	"	39634	Dec 20	1944 Profits		129936 5
June 13	2nd " "	"	1755 87				5958 51
Sept 5	State Profits Tax	"	1809 03				
" 14	Income Tax 3rd " "	"	3014 40				
Dec 30	Balance		6327 97				
Mar 12	1944 Est. Tax	CD	5293 56				
" 12	1944 Est. Tax		5845 87				
Apr 12	1944 State Income Tax	"	625 16	Jan 1	Balance		5812 58
June 11	Est. 1945 2nd " "	"	824 26	Profits w/ Tax Paid	CR		5382 50
Sept 6	" " 2nd " "	"	121 68	To A. Harris - Profits	117		13797
Dec 31	Bal. fund.		625 18	" State Income Tax	117		1210 6
			2276 68	" Profits	"		1875
			7207 08	1945 Profits	Dec 10		5698 47
							7488 37

PETITIONERS' EXHIBIT No. 16

[Union Manufacturing Co. Letterhead]

BALANCE SHEET—December 31, 1942

ASSETS

Petty Cash	\$ 35.49	
Union Bank & Trust Co.—Checking Act.	166,571.62	
Union Bank & Trust Co.—Payroll Acct.	100.00	
State National Bank—El Paso, Tex.....	7,797.08	
Accounts Receivable—Good	187,880.36	
Accounts Receivable—Doubtful	1,788.20	
Loans to Employees.....	106.73	
Inventory 12/21/42	538,992.70	
Machinery	40,211.68	
Furniture & Fixtures.....	694.09	
Automobile	859.80	
Stationery & Printing	400.00	
Prepaid Insurance	537.48	
		<hr/>
		\$945,975.23

LIABILITIES

Employees—Salaries, commissions, etc. \$	449.94	
Social Security—Employees	2,240.74	
Social Security—Firm	6,374.72	
		<hr/>
		\$ 9,065.40

CAPITAL

M. Harris:	\$359,705.94	
Less drawing acct.	\$28,050.00	
Less income tax 1941.....	86,238.30	
Less income tax 1940		
(add.)	92.08	114,380.38
		<hr/>
		\$245,325.56
Plus ½ 1942 profits.....	226,025.48	471,351.04
		<hr/>
A. Harris:	\$334,699.14	
Less drawing acct.....	\$14,949.35	
Less income tax 1941.....	80,216.48	95,165.83
		<hr/>
		\$239,533.31
Plus ½ 1942 profits.....	226,025.48	465,558.79
		<hr/>
		\$945,975.23

[Endorsed]: T.C.U.S. Admitted in evidence Jan.
29, 1948. [191]

PETITIONERS' EXHIBIT No. 17

[Union Manufacturing Co. Letterhead]

BALANCE SHEET—December 31, 1943

ASSETS

Petty Cash	\$ 34.02	
Union Bank & Trust Co.—Regular Acct.	94,890.28	
Union Bank & Trust Co.—Payroll Acct.	100.00	
State National Bank of El Paso.....	7,054.83	
Accounts Receivable—Good	163,653.19	
Accounts Receivable—Doubtful	1,708.92	
Loans to Employees.....	174.14	
War Bonds	40,000.00	
Inventory of Mdse. 12/17/43.....	586,878.36	
Machinery	34,801.45	
Furniture & Fixtures.....	741.19	
Automobile	368.40	
Real Estate—El Paso (deposit).....	2,500.00	
Stationery & Printing.....	400.00	
Prepaid Insurance	1,170.49	
		<hr/>
		\$934,475.27

LIABILITIES

Due Salesmen	\$ 3,736.47	
Social Security—Employees	2,143.07	
Social Security—Firm	6,341.77	
Reserve for Income Tax—1942.....	84,887.22	
20% Withholding Taxes	11,711.02	
		<hr/>
		\$108,819.55

CAPITAL

M. Harris:	\$471,351.04	
Less 1942 Res. for Inc. Tax.....	201,283.62	
		<hr/>
	\$270,067.42	
Less adj. on 1940 State tax.....	18.06	
		<hr/>
	270,049.36	
Less Capital—Albert Harris—		
1/16 Int.	34,083.70	
		<hr/>
	\$235,965.66	
Less Drawings for year.....	41,579.45	
		<hr/>
	\$194,386.21	
Plus 7/16 1943 Profit.....	161,059.09	
		<hr/>
		\$355,445.30

A. Harris	\$465,558.79	
Less 1942 Reserve for Inc. Tax.....	190,269.06	
	<hr/>	
	\$275,289.73	
Less Capital Betty Harris—1/16 Int.	34,083.70	
	<hr/>	
	\$241,206.03	
Less drawings for year.....	24,204.42	
	<hr/>	
	\$217,001.61	
Plus 7/16 years profits.....	161,059.09	
	<hr/>	
		\$378,060.70
Albert Harris	\$ 34,083.70	
Less Estimated tax 1943.....	9,879.79	
	<hr/>	
	\$ 24,203.91	
Less 1/16 drawings.....	1,137.50	
	<hr/>	
	\$ 23,066.41	
Plus 1/16 1943 profits.....	23,008.45	
	<hr/>	
		\$ 46,074.86
Betty Harris	\$ 34,083.70	
Less Estimated tax 1943.....	9,879.79	
	<hr/>	
	\$ 24,203.91	
Less 1/16 drawings	1,137.50	
	<hr/>	
	\$ 23,066.41	
Plus 1/16 1943 profits.....	23,008.45	
	<hr/>	
		\$ 46,074.86
	<hr/>	
		\$934,475.27

[Endorsed]: T.C.U.S. Admitted in evidence Jan.
29, 1948. [193]

In the United States Circuit Court of Appeals
For the Ninth Circuit

Docket Nos. 12984, 12985
(Tax Court)

ANNA HARRIS and MORRIS HARRIS,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REVIEW OF DECISION OF
THE TAX COURT OF THE UNITED STATES

To the Honorable Judges of the United States
Circuit Court of Appeals for the Ninth Circuit:

Anna Harris and Morris Harris, petitioners in
the above entitled cases which were consolidated
for trial below, hereby petition this court to re-
view the decision of the Tax Court of the United
States heretofore entered in said proceeding on
May 12, 1848. Petitioners respectfully represent:

I.

This petition is filed pursuant to Internal Reve-
nue Code sections 1141 and 1142, 26 U.S.C.A., sec-
tions 1141 and 1142. [194]

II.

Nature of Controversy

The present controversy relates to the proper
determination of petitioners' federal income and

victory taxes for the calendar year 1943 and federal income taxes for the calendar year 1944.

Respondent determined deficiencies to be due from petitioners for the calendar years 1943 and 1944 as follows:

Anna Harris:

1943	\$5,662.73
1944	18,136.67

Morris Harris:

1943	\$ 6,036.87
1944	18,693.10

The Tax Court of the United States, by its said decision, sustained respondent in his determinations and petitioners hereby petition for a review of said decision of the Tax Court of the United States.

III.

Venue

Petitioners filed their respective separate federal income tax returns for the calendar years 1943 and 1944 with the Collector of Internal Revenue for the Sixth District of California. Accordingly, petitioners are petitioning for a review of the said decision of the Tax Court of the United States by this Circuit Court of Appeals for the Ninth Circuit.

Wherefore, your petitioners pray that this court review the said decision of the Tax Court of the United States, [195] reverse the said decision of said Tax Court, and direct entry of a decision by

said Tax Court in favor of petitioners and each of them, determining that no deficiencies in federal income or victory taxes for the calendar years 1943 and 1944 are due from the petitioners or either of them.

Dated July 29, 1948.

Respectfully submitted,

/s/ DANA LATHAM,
Attorney for Petitioners.

(Duly Verified.)

[Endorsed]: T.C.U.S. Aug. 4, 1948. [196]

[Title of U. S. Court of Appeals and Causes.]

NOTICE OF FILING OF PETITION
FOR REVIEW

To the Commissioner of Internal Revenue, Washington, D. C.:

You are hereby notified that Anna Harris and Morris Harris, petitioners in the above entitled proceeding in the Tax Court of the United States is petitioning the United States Circuit Court of Appeals for the Ninth Circuit to Review the decision of said Tax Court heretofore rendered in

the above-entitled Tax Court case on May 12, 1948. The petition for review, copy of which is attached hereto, and this notice of filing of petition for review are hereby served upon you.

Dated July 29, 1948.

/s/ DANA LATHAM,
Attorneys for Petitioners.

(Acknowledgment of Service.)

[Endorsed]: T.C.U.S. Filed Aug. 4, 1948. [198]

[Title of U. S. Court of Appeals and Cause.]

DESIGNATION OF CONTENTS OF RECORD
ON APPEAL AND STATEMENT OF POINTS

To Victor S. Mersch, Clerk of the Tax Court of
the United States, Washington, D. C.:

Petitioners in the above-entitled consolidated proceedings hereby designate the following portions of the record, proceedings, and evidence before the Tax Court of the United States to be contained in the record on review before the Circuit Court of Appeals for the Ninth Circuit:

- (1) Docket entries.
- (2) Petition and amended petition of petitioner Anna Harris (Docket No. 12984).
- (3) Petition and amended petition of petitioner Morris Harris (Docket No. 12985).
- (4) Answer to petition and amended petition of [201] petitioner Anna Harris (Docket No. 12984).

(5) Answer to petition and amended petition of petitioner Morris Harris (Docket No. 12985).

(6) Findings of fact and opinion of the Tax Court.

(7) Decision of the Tax Court, if separate and distinct from (6) above.

(8) The reporter's transcript of proceedings before the Tax Court.

(9) The following exhibits introduced in evidence by petitioners at the hearing before the Tax Court:

1. Petitioners' Exhibit "1".
2. Petitioners' Exhibit "2".
3. Petitioners' Exhibit "3".
4. Petitioners' Exhibit "5".
5. Petitioners' Exhibit "6".
6. Petitioners' Exhibit "7".
7. Petitioners' Exhibit "8".
8. Petitioners' Exhibit "9."
9. Petitioners' Exhibit "10".
10. Petitioners' Exhibit "11".
11. Petitioners' Exhibit "12".
12. Petitioners' Exhibit "13".
13. Petitioners' Exhibit "14".
14. Petitioners' Exhibit "15".
15. Petitioners' Exhibit "16".
16. Petitioners' Exhibit "17".

[202]

(10) The petition for review of decision of the Tax Court and notice of filing of petition for review, together with proof of service of said petition and said notice of filing petition.

(11) This designation of contents of record on appeal and statement of points and the notice of filing thereof, together with proof of service of said designation and notice.

STATEMENT OF POINTS ON WHICH
PETITIONER INTENDS TO RELY

(1) The Tax Court erred in entering decisions for respondent.

(2) The Tax Court erred in not entering decisions for petitioners and each of them.

(3) The Tax Court erred in failing to find or conclude that there were no deficiencies in income and victory taxes due from petitioners or either of them for the calendar years 1943 and 1944.

(4) The Tax Court erred in failing to find or conclude that there was, as of January 1, 1943, a completed gift in praesenti to petitioners' son Albert of a one-sixteenth interest in petitioners' business, which vested him with complete dominion and control over an interest in and earnings of said business. [203]

(5) The Tax Court erred in failing to find or conclude that there was, as of January 1, 1943, a completed gift in praesenti to petitioners' daughter, Betty of a one-sixteenth interest in petitioners' business, which vested her with complete dominion and control over an interest in and earnings of said business.

(6) The Tax Court erred in failing to find or conclude that petitioners' son Albert was a bona

fide partner with petitioners and Betty Harris throughout the calendar years 1943 and 1944.

(7) The Tax Court erred in failing to find or conclude that petitioners' daughter Betty was a bona fide partner with petitioners and Albert Harris throughout the calendar years 1943 and 1944.

(8) The Tax Court erred in failing to find or conclude that petitioners' son Albert was the owner of and taxable on his share of the income of the partnership referred to in (6) and (7) above for the calendar years 1943 and 1944 as shown on petitioners' Exhibits "5", "6", and "14".

(9) The Tax Court erred in failing to find or conclude that petitioners' daughter Betty was the owner of and taxable on her share of the income of the partnership referred to in (6) and (7) above for the calendar years 1943 and 1944 as shown on petitioners' Exhibits "5", "6", and "15".

(10) The Tax Court erred in finding or concluding that petitioners were each taxable on 50% of the income of the [204] partnership referred to in (6) and (7) above for the calendar years 1943 and 1944.

(11) The Tax Court erred in finding or concluding that the said partnership had two members only, Anna and Morris Harris, during the calendar years 1943 and 1944, and in failing to find or conclude that said partnership had four members, Anna, Morris, Albert, and Betty Harris, during said years.

(12) Assuming, but not conceding, that the Tax

Court did not err in finding or concluding that Albert and Betty Harris were not bona fide partners with petitioners during the calendar years 1943 and 1944, then the Tax Court erred in failing to find or conclude that the said Albert and Betty Harris were each the owners of their respective interests in the capital of the business and the owners of and taxable on the income of said business to the extent attributable to their said respective interests in said capital and in failing and refusing to fix and determine the amount of income so attributable to said capital interests.

(13) The Tax Court erred in failing to find or conclude that the \$25,256.18 California income tax paid by the petitioner Anna Harris during the calendar year 1943 was deductible by said petitioner in computing victory tax net income for said year.

(14) The Tax Court erred in failing to find or conclude that the \$26,746.65 California income tax paid by the petitioner Morris Harris during the calendar year 1943 was [205] deductible by said petitioner in computing victory tax net income for said year.

Dated August 4, 1948.

Respectfully submitted,

/s/ DANA LATHAM,

/s/ D. WEBSTER EGAN,

Attorneys for Petitioners.

[Endorsed]: T.C.U.S. Filed Aug. 6, 1948. [206]

[Title of U. S. Court of Appeals and Cause.]

NOTICE OF FILING OF DESIGNATION OF
CONTENTS OF RECORD ON APPEAL
AND STATEMENT OF POINTS

To the Commissioner of Internal Revenue, Wash-
ington, D. C.:

You are hereby notified that Anna Harris and Morris Harris, petitioners in the above-entitled proceeding in the Tax Court of the United States, are filing with the Clerk of the Tax Court petitioners' designation of contents of record on appeal and statement of points. The said designation of contents of record on appeal and statement of points, a copy of which is attached hereto, together with this notice of filing of same, are hereby served upon you.

Dated August 4, 1948.

/s/ DANA LATHAM,

/s/ D. WEBSTER EGAN,

Attorneys for Petitioners.

(Affidavit of Service attached.)

[Endorsed]: Filed Aug. 6, 1948.

[207]

[Title of U. S. Court of Appeals and Cause.]

DESIGNATION OF ADDITIONAL PORTIONS
OF RECORD

To the Clerk of The Tax Court of the United
States:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct, of the following additional documents and records in the above-entitled causes in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the taxpayers, petitioners herein:

1. Petitioners' Exhibit 4.

/s/ THERON L. CAUDLE,
Assistant Attorney General.

/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue.
Attorneys for Respondent on
Review.

(Acknowledgment of Service attached.)

[Endorsed]: T.C.U.S. Filed Aug. 24, 1948. [209]

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 209, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 30th day of September, 1948.

(Seal) /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the United States.

[Endorsed]: No. 12060. United States Court of Appeals for the Ninth Circuit. Anna Harris and Morris Harris, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed October 11, 1948.

 /s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

In the United States Court of Appeals for the
Ninth Circuit

Docket No. 12060

ANNA HARRIS and MORRIS HARRIS,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENTS OF POINTS AND DESIGNA-
TION OF PARTS OF RECORD TO BE
PRINTED

To the Clerk of the United States Court of Appeals
for the Ninth Circuit:

I.

STATEMENT OF POINTS

Petitioners respectfully state that upon the hearing on their petition for review herein, petitioners intend to rely upon all of the points specified in their "Designation of Contents of Record on Appeal and Statement of Points" heretofore filed with the Clerk of the Tax Court of the United States, which points are incorporated herein by reference.

II.

DESIGNATION OF PARTS OF RECORD
TO BE PRINTED

Petitioners respectfully submit that all of the record on review, as certified to you, with the exception of Petitioners' Exhibit 4 certification of which was requested by respondent, will be necessary for the consideration of the points upon which petitioners intend to rely. Accordingly, petitioners respectfully request you to have printed the entire record on review except Petitioners' Exhibit 4.

/s/ DANA LATHAM,

/s/ HENRY C. DIEHL,

/s/ D. WEBSTER EGAN,

Attorneys for Petitioners.

(Affidavit of Service attached.)

[Endorsed]: Filed October 26, 1948. Paul P. O'Brien, Clerk.